STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Geneseo Telephone Company,	**:**	
Cambridge Telephone Company and	**:**	
Henry County Telephone Company	**:**	
	:	**11-0210**
Petition for Universal Service Support.	**:**	
	:	
Illinois Independent Telephone	**:**	**(Cons.)**
Association	**:**	
	:	
Petition to update the Section	**:**	
13-301(1)(d) Illinois Universal Service	**:**	**11-0211**
Fund and to implement Intrastate	**:**	
Switched Access Charge reform as	**:**	
described herein and for other relief.	**:**	

PROPOSED ORDER

DATED: January 17, 2013

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Geneseo Telephone Company, Cambridge Telephone Company and Henry County Telephone Company	:	
	:	**11-0210**
Petition for Universal Service Support.	:	
	:	
Illinois Independent Telephone Association	:	**(Cons.)**
	:	
Petition to update the Section 13-301(1)(d) Illinois Universal Service Fund and to implement Intrastate Switched Access Charge reform as described herein and for other relief.	:	**11-0211**

PROPOSED ORDER

By the Commission:

I. PROCEDURAL HISTORY

In Docket No. 11-0210, Geneseo Telephone Company, Cambridge Telephone Company and Henry County Telephone Company ("GCHC," "Geneseo" or "Geneseo Companies") filed, with the Illinois Commerce Commission ("Commission"), a verified petition requesting that the Commission "investigate and update changes" to the Illinois Universal Service Fund (the "IUSF") pursuant to Sections 13-301(1)(d) and 13-301(2)(a) of the Illinois Public Utilities Act (the "PUA" or the "Act").

In Docket No. 11-0211, the Illinois Independent Telephone Association ("IITA") filed with the Commission a verified Petition to update the Section 13-301(1)(d) IUSF and to implement Intrastate Switched Access Charge reform.

Petitions to Intervene in Docket No. 11-0210 were filed by AT&T Illinois and Gallatin River Communications L.L.C. d/b/a CenturyLink, and were granted.

Petitions to intervene in Docket No. 11-0211 were filed by Illinois Bell Telephone Company ("AT&T Illinois"); Gallatin River Communications L.L.C. d/b/a CenturyLink; Adams Telephone Co-Operative; Alhambra-Grantfork Telephone Co.; Cass Telephone Company; Crossville Telephone Company; Egyptian Telephone Cooperative Assn.; FairPoint Communications (C-R), FairPoint Communications (El Paso), FairPoint Communications (Odin); Flat Rock Telephone Co-op, Inc.; Glasford Telephone Company; Grafton Telephone Company; Gridley Telephone Company; Hamilton County

Telephone Co-op; Harrisonville Telephone Company; Home Telephone Company; La Harpe Telephone Company, Inc.; Leaf River Telephone Company; Madison Telephone Company; Marseilles Telephone Company; McDonough Telephone Cooperative; McNabb Telephone Company; Metamora Telephone Company; Mid-Century Telephone Cooperative; Montrose Mutual Telephone Co., Inc.; Moultrie Independent Telephone Co.; New Windsor Telephone Company, Inc.; Oneida Telephone Company; Reynolds Telephone Company; Shawnee Telephone Company; Tonica Telephone Company; Viola Home Telephone Company; Wabash Telephone Coop, Inc.; Woodhull Telephone Company; First Communications, LLC; McLeodUSA Telecommunications Services, L.L.C. d/b/a PAETEC Business Services; TW Telecom of Illinois, Inc.; Geneseo Telephone Company; Cambridge Telephone Company and Henry County Telephone Company. These petitions were granted.

The Staff of the Commission ("Staff") filed a motion to consolidate these dockets. The motion was granted.

Petitions to intervene in the consolidated dockets were filed by Frontier North Inc., Frontier Communications Of The Carolinas Inc., Citizens Telecommunications Company Of Illinois, Frontier Communications – Midland, Inc., Frontier Communications – Prairie, Inc., Frontier Communications – Schuyler, Inc., Frontier Communications Of Depue, Inc., Frontier Communications Of Illinois, Inc., Frontier Communications Of Lakeside, Inc., Frontier Communications Of Mt. Pulaski, Inc., Frontier Communications Of Orion, Inc. (jointly, "Frontier" or the "Frontier Companies"), all of which were granted. A petition to intervene in the consolidated docket filed by the TW Telecom of Illinois, Inc. was granted.

Companies sometimes referred to as "IITA Member Intervenors" are Adams Telephone Co-Operative, Alhambra-Grantfork Telephone Co., Cass Telephone Company, Egyptian Telephone Cooperative Assn., Flat Rock Telephone Co-op, Inc., Grafton Telephone Company, Gridley Telephone Company, Hamilton County Telephone Co-op, Harrisonville Telephone Company, Home Telephone Company, La Harpe Telephone Company, Inc., Leaf River Telephone Company (Leaf River"), Madison Telephone Company, McDonough Telephone Cooperative, McNabb Telephone Company, Metamora Telephone Company, Mid-Century Telephone Cooperative, Montrose Mutual Telephone Co., Inc., Moultrie Independent Telephone Co., New Windsor Telephone Company, Inc., Oneida Telephone Company, Reynolds Telephone Company, Shawnee Telephone Company, Viola Home Telephone Company, Wabash Telephone Coop, Inc., and Woodhull Telephone Company

During the course of the proceedings, Crossville Telephone Company, FairPoint Communications (C-R), FairPoint Communications (El Paso), FairPoint Communications (Odin), Glasford Telephone Company, Marseilles Telephone Company, Tonica Telephone Company and Stelle Telephone Company sought and were granted leave to withdraw. Because these IITA companies are no longer intervenors or seeking IUSF funding from an updated interim fund, they will not be subject to this Order. Following the closing of the record in this docket, McLeodUSA

Telecommunications Services, L.L.C. d/b/a PAETEC Business Services also sought and was granted leave to withdraw.

The IITA filed a motion for leave to file a First Amended Petition on May 5, 2011, which was granted. Thereafter, direct testimony was filed by GCHC, the IITA and each of the IITA Member Intervenors, and AT&T Illinois. Staff filed direct testimony. The IITA and a number of IITA Member Intervenors, AT&T Illinois and Frontier filed rebuttal testimony. Due to the expectancy and subsequent issuance of an FCC order on federal universal service reform and intercarrier compensation (the so-called "*ICC/USF Transformational Order*" or "*ICC/USF Order*"), the testimony schedule in the docket was continued twice. Ultimately, further direct and rebuttal testimony was filed on March 23, 2012 by GCHC, the IITA, each of the IITA Member Intervenors, AT&T, and Frontier.

A Petition to intervene in the consolidated docket filed by the Cable Television & Communications Association ("Cable Association" or "CT&C") on April 16, 2012 was granted.

On May 25, 2012, responsive testimony was filed by Staff, additional rebuttal testimony was filed by GCHC, the IITA, AT&T, and rebuttal testimony was filed by the Cable Association. On June 29, 2012, surrebuttal testimony was filed by GCHC, the IITA, and AT&T Illinois. On July 19 and 23, 2012, Staff filed supplemental rebuttal testimony.

At the hearings, appearances were entered on behalf of the Parties. The Parties' testimony and exhibits were admitted into the record. At the conclusion of the hearings, the record was marked "Heard and Taken."

Initial briefs ("IBs") and reply briefs ("RBs") were filed by IITA; AT&T Illinois; GCHC; Cass Telephone Company, et al.; CT&C; Alhambra-Grantfork, et al.; and Staff. Frontier filed an initial brief. A draft order ("Joint draft order") was filed jointly by IITA, individual IITA Intervenor companies, AT&T Illinois, Staff and Frontier. Draft orders were also filed by CT&C and by GCHC. On December 18, Leaf River filed a motion to reopen; on or before January 2, 2013, AT&T Illinois and Staff filed responses objecting to the motion; on January 15, 2012 Leaf River filed a reply.

II. SUMMARY OF POSITIONS AND RELIEF SOUGHT

The IITA requests an interim update to the IUSF to increase the size of the fund consistent with changes in circumstances since the initial fund was established by this Commission in 2001 in Docket Nos. 00-0233 and 00-0335 (the "Prior Consolidated Dockets"). Initially, the IITA's Petition sought an additional change to the IUSF to establish a separate element of the fund for revenues lost as result of the IITA Member Intervenors agreeing to reduce their intrastate switched access rates to mirror their interstate switched access rates. Due to changes relating to intrastate terminating switched access imposed by the FCC and the Commission Staff's objection to creating a separate element of the fund, the IITA updated its Petition to reflect revenue

reductions from the mirroring of intrastate originating switched access in its request for an update of the basic IUSF. In total, the IITA is seeking an updated fund size of just over $19 million, allocated to individual companies on the basis of Schedule 1.01s that establish each company's showing of need. (Joint draft order at 3)

In addition, the IITA reached a "Consensus Position" with Staff and AT&T Illinois regarding certain conditions that "should be" included in any Order in this docket and that "should apply" to an updated IUSF. Based both on its Petition and the Consensus Position, the IITA emphasizes that this is an interim update to the IUSF. Following an order in this docket establishing an interim update to the fund, the IITA has committed to engage in a more comprehensive review of the IUSF taking into account any further FCC changes to intercarrier compensation and federal universal service. (*Id*.)

The Cable Association, also known as CT&C, takes no position regarding the IITA's request for an increase in the IUSF regarding basic elements. However, CT&C maintains that the "IITA/AT&T Illinois additional proposal," to further increase the IUSF to recover the reduced ILEC revenues resulting from a lowering of intrastate originating access rates, is inconsistent with the public policy determinations made by the FCC and the Illinois General Assembly for balancing the transition of access charge reform with the provision of universal service. (CT&C draft order at 1)

Cass Telephone Company et al., also known as the S Corporations, take issue with a Staff-proposed adjustment to allow no amount for imputed income taxes in calculating the level of IUSF funding for the S Corporations.

Geneseo et al., known as "GCHC," request that the Commission expand the current group of nine supported telecommunications services to include a 10th service titled "Access to Broadband Services." In connection with establishing Access to Broadband Services as a supported telecommunications service, GCHC proposes that the Commission establish the affordable rate for this service at $15.46 per line per month, and that actual invoiced costs spent for Access to Broadband Services be used as the economic costs for purposes of determining the proxy costs for this service. GCHC proposes that these be used as an alternative means a carrier could elect to be used to establish and administer its IUSF funding. Based on Access to Broadband Services being added as a supported telecommunications service and its proposed alternative approach for funding, GCHC requests the Commission establish that IUSF funding be available for Geneseo, Cambridge and Henry County in the amounts of $1,100,319, $222,438 and $207,040, respectively. (GCHC draft order at 6)

The Parties' positions on the issues are described in more detail below.

III. STATUTORY AUTHORITY; IUSF HISTORY

With respect to applicable statutory authority, the filers of the joint draft order, and GCHC, state that the issues in this docket are ultimately subject to the following section of the PUA:

Sec. 13-301. Duties of the Commission.

(1) Consistent with the findings and policy established in paragraph (a) of Section 13-102 and paragraph (a) of Section 13-103, and in order to ensure the attainment of such policies, the Commission shall:

(a) participate in all federal programs intended to preserve or extend universal telecommunications service, unless such programs would place cost burdens on Illinois customers of telecommunications services in excess of the benefits they would receive through participation, provided, however, the Commission shall not approve or permit the imposition of any surcharge or other fee designed to subsidize or provide a waiver for subscriber line charges; and shall report on such programs together with an assessment of their adequacy and the advisability of participating therein in its annual report to the General Assembly, or more often as necessary;

(b) (blank);

(c) order all telecommunications carriers offering or providing local exchange telecommunications service to propose low-cost or budget service tariffs and any other rate design or pricing mechanisms designed to facilitate customer access to such telecommunications service, provided that services offered by any telecommunications carrier at the rates, terms, and conditions specified in Section 13-506.2 or Section 13-518 of this Article shall constitute compliance with this Section. A telecommunications carrier may seek Commission approval of other low-cost or budget service tariffs or rate design or pricing mechanisms to comply with this Section;

(d) investigate the necessity of and, if appropriate, establish a universal service support fund from which local exchange telecommunications carriers who pursuant to the Twenty-Seventh Interim Order of the Commission in Docket No. 83-0142 or the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679 received funding and whose economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services; provided, however, that if a universal service support fund is established, the Commission shall require that all costs of the fund be recovered from all local exchange and interexchange telecommunications carriers certificated in Illinois on a competitively neutral and nondiscriminatory basis. In establishing any such universal service support fund, the Commission shall, in addition to the

> determination of costs for supported services, consider and make findings pursuant to subsection (2) of this Section. Proxy cost, as determined by the Commission, may be used for this purpose. In determining cost recovery for any universal service support fund, the Commission shall not permit recovery of such costs from another certificated carrier for any service purchased and used solely as an input to a service provided to such certificated carrier's retail customers.
>
> (2) In any order creating a fund pursuant to paragraph (d) of subsection (1), the Commission, after notice and hearing, shall:
>
> (a) Define the group of services to be declared "supported telecommunications services" that constitute "universal service". This group of services shall, at a minimum, include those services as defined by the Federal Communications Commission and as from time to time amended. In addition, the Commission shall consider the range of services currently offered by telecommunications carriers offering local exchange telecommunications service, the existing rate structures for the supported telecommunications services, and the telecommunications needs of Illinois consumers in determining the supported telecommunications services. The Commission shall, from time to time or upon request, review and, if appropriate, revise the group of Illinois supported telecommunications services and the terms of the fund to reflect changes or enhancements in telecommunications needs, technologies, and available services.
>
> (b) Identify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund.
>
> (c) Establish an affordable price for the supported telecommunications services for the respective incumbent local exchange carrier. The affordable price shall be no less than the rates in effect at the time the Commission creates a fund pursuant to this item. The Commission may establish and utilize indices or models for updating the affordable price for supported telecommunications services.

At its base, Section 13-301(1)(d) states that the Commission shall investigate the necessity of, and if appropriate, establish a universal service fund for those carriers who received funding pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142 or the Commission's Orders in Docket Nos. 97-0621 and 98-0679. This definition of eligible carriers includes virtually all the carriers in Illinois with fewer than 35,000 access lines and includes every one of the IITA Member Intervenors, the Frontier companies that are seeking funding in this docket and the GCHC companies. The statute further details the Commission's obligations in establishing a universal

service fund. After reviewing these provisions, the Commission in the Prior Consolidated Dockets established the basic elements of the IUSF, through the Commission's Second Interim Order, entered September 18, 2001, with the effective date of the fund being October 1, 2001. (Joint draft order at 5; GCHC draft order at 8-9)

The joint draft order further states, "In addition, the statute provided that prior to establishing an IUSF, the Commission had to … define the group of supported telecommunications services that include universal service, including at a minimum those services as defined by the FCC; … identify the ILECs' economic cost of providing the supported services; … establish an affordable price, which shall be no less than the existing rates of the supported services; … identify support to be provided taking into account any federal universal service support received for providing the same services; identify all implicit subsidies contained in rates or charges of ILECs, including interexchange access charges, and determine how such funds can be made explicit by the creation of the fund; … require that all costs of the fund be recovered from all local exchange and interexchange carriers certificated in Illinois on a competitively neutral and nondiscriminatory basis; … and not permit universal service support cost recovery from another certificated carrier for any service purchased and used solely as an input to a service provided to such certificated carrier's retail customers." (Joint draft order at 5-6)

Filers of the joint draft order, and GCHC, further state that In the intervening 10 years, the FCC has issued a number of orders and notices related to intercarrier compensation and the federal USF issues, but did not act, leaving the industry to await the much anticipated FCC reforms. In April, 2010 the FCC issued a Notice of Proposed Rulemaking and Notice of Inquiry related to various issues related to the federal USF. In November of 2011, the FCC issued the *ICC/USF Transformational Order*. *Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 Issued November 18, 2011. (Joint draft order at 6; GCHC draft order at 9)

IV. PROPOSAL ADVANCED IN IITA/AT&T/STAFF CONSENSUS POSITION

Following a review of the FCC's *Transformational Order*, the IITA, the IITA Member Intervenors, the Staff, AT&T Illinois, and the Frontier Companies presented a Consensus Position and an interim update to the IUSF based on their Consensus Position. The Cable Association opposes certain elements of the Consensus Position, particularly the originating access proposal. The positions of the parties are summarized below.

The Commission observes that the descriptions and summaries of parties' positions on these and other issues, wherever they may be contained in this order, are not intended to reflect the opinions of or determinations by the Commission unless otherwise noted.

A. IITA Position

As explained in the joint draft order, the IITA requests an interim update to the IUSF to increase the size of the fund consistent with changes in circumstances since the initial fund was established by this Commission in 2001 in Docket Nos. 00-0233 and 00-0335 (the "Prior Consolidated Dockets"). Initially, the IITA's Petition sought an additional change to the IUSF to establish a separate element of the fund for revenues lost as result of the IITA Member Intervenors agreeing to reduce their intrastate switched access rates to mirror their interstate switched access rates. Due to changes relating to intrastate terminating switched access imposed by the FCC and the Commission Staff's objection to creating a separate element of the fund, the IITA updated its Petition to reflect revenue reductions from the mirroring of intrastate originating switched access in its request for an update of the basic IUSF. In total the IITA is seeking an updated fund size of just over $19 million, allocated to individual companies on the basis of Schedule 1.01s that establish each company's showing of need. (Joint draft order at 3)

In addition, the IITA reached a "Consensus Position" with Staff regarding certain conditions that both agreed should be included in any Order in this docket and that should apply to an updated IUSF. Based both on its Petition and on a Consensus Position the IITA reached with Staff, the IITA emphasizes that this is an interim update to the IUSF. Following an order in this docket establishing an interim update to the fund, the IITA has committed to engage in a more comprehensive review of the IUSF taking into account any further FCC changes to intercarrier compensation and federal universal service.

These "main" points of the Consensus Position, as outlined in the Staff Exhibit 4.0, are as follows:

> 1. These dockets should result in approval of an Interim Fund updating the present IUSF. Work on the Investigation and development of a longer-term IUSF, presumptively based upon a different methodology, to replace this Interim Fund, should commence within ninety days of issuance of an Order in these dockets approving the interim Fund. No later than two years from issuance of an Order in these dockets approving the Interim Fund, one or more eligible recipients of IUSF or an organization representing them, such as the IITA, will petition the Commission for approval of a longer-term IUSF to replace this Interim Fund. Such petition, and any resulting longer-term IUSF, shall be based upon a different methodology, absent a showing that no such alternative methodology is feasible.
>
> 2. The Interim Fund should be based upon an updated "need showing" using the Schedule 1.01 methodology used by the Commission in establishing the original IUSF effective October 1, 2001. That analysis and showing will also incorporate the affect of all companies seeking and

qualifying for the Interim Fund reducing originating intrastate switched access charges to "mirror" originating interstate switched access charges contemporaneous with the effective date of the Interim Fund.

3. The IITA agrees that any "Longer Term" IUSF replacing the Interim IUSF resulting from the instant docket shall be (a) compliant with the terms and requirements of Section 13-301 of the Illinois Public Utilities Act, (b) consistent with and fully reflect the Commission's concerns and admonitions, as stated in its several Orders in Docket Nos. 00-0233/0335 and 04-0354, regarding continued use of rate-of-return based methodology to determine IUSF support levels, and (c) consistent with FCC policies and rules applicable on an interstate level to Illinois ILECs potentially eligible for IUSF support pursuant to Section 13-301(1)(d) of the Illinois PUA.

4. The Interim Fund will terminate on the implementation of the longer-term IUSF.

In working toward its Consensus Position with Staff and the other parties for the establishment of an interim update to the IUSF, the IITA sought to work within the framework of prior Commission Orders including the orders in the Prior Consolidated Dockets and to apply conservative approaches. The IITA asserts that no party to this docket opposes the Consensus Position, and the only objections to any part of the IITA's Proposal are Staff's objection to allowing S corporations to impute the tax liability of their shareholders and the Cable Association's objection to the inclusion of mirroring for originating access. Nevertheless, because neither the Stipulation and Agreement nor the Consensus Position constitutes a stipulation among all the parties to the case, and to ensure the Commission had an adequate record, the IITA is not relying solely on the agreements and understandings it has reached, but has also submitted substantial record evidence supporting each element of the Consensus Position and the update of the IUSF. (Joint draft order at 21)

For example, in the Prior Consolidated Dockets, the Commission set the required affordable rate at a level of $20.39 based on the substantial record evidence in those dockets. (IITA draft order at 21, citing IITA Exhibit 1.0 at lines 490-530) The initial Stipulation and Agreement with AT&T Illinois provided that the affordable rate should remain at the $20.39 level and that proposal has not changed. Moreover, Staff and Frontier both signaled agreement by incorporating that affordable rate into their own computations of the updated fund size. The $20.39 rate, however, both nationally and within Illinois, is at the "very high end" of local rates within the nation. (*Id.*, citing IITA Exhibit 1.0 at lines 509-510) As depicted in IITA Exhibit 1.05, this rate would be in the top 9.0% of the local rates in the nation and, as shown in IITA Exhibit 1.06, it would be within the top 2.2% of the local rates in Illinois. (Joint draft order at 21)

Also, based on the latest data published in FCC reports, the representative monthly charge for local service in October, 2007 for the 95 largest urban areas was

$15.62 with an additional $5.74 for subscriber line charges equaling a total of $21.36. (IITA Exhibit 1.0 at lines 517-522) These rates "compare respectively to $20.39 for the Illinois affordable rate (31% higher than the nationwide urban average) with an additional $6.50 for subscriber line charges equaling a total of $26.89 (about 26% higher than the nationwide urban average)." (Joint draft order at 21)

In making these comparisons the IITA encourages the Commission to keep in mind that the local calling areas for rural telephone companies generally involve only a few hundred to a few thousand customers while local rates in large urban areas such as Chicago may give the customer access to hundreds of thousands or millions of local customers. (IITA Exhibit 1.0 at lines 512-516) Notably, any downward adjustment to the affordable rate (as the evidence suggests) would raise the amount of IUSF funding necessary to provide service at that adjusted rate. The IITA, however, has sought compromises that support an expeditious adoption of an interim update to the IUSF. (*Id.* at 525-530)

Consistent with the statutory requirements, the IITA "provided record evidence that the IITA Member Intervenors have an economic cost greater than the affordable rate less federal universal service support." The IITA addressed this first through the Stipulation and Agreement where the IITA and AT&T Illinois agreed the IITA would introduce updated forward-looking HAI cost model results. In developing the determination of meeting the statutory requirements, the IITA used the approach adopted by the Commission in the Prior Consolidated Dockets. The PUA allows for proxy costs to be used in the determination of the economic costs of the companies. In the Prior Consolidated Dockets, the Commission approved using the costs of the combined companies as a proxy for the costs of each of the companies. (Joint draft order at 22)

The results of the HAI studies were first summarized in IITA Exhibit 1.07, as filed with the direct testimony of Robert Schoonmaker. The IITA updated this filing in March of 2012, reflecting various individual company adjustments, and the withdrawal of certain Small ILECs from the docket and from the updated fund. With those adjustments, Exhibit 1.07 (revised 3/23/12) shows that the weighted average monthly USF cost per line across all the IITA Member Intervenors (using actual company access lines) is $90.35. The weighted average cost is the proxy cost as that term is used in the statute for the total group of companies. (*Id.*)

Using the statutory proxy cost criteria, the HAI analysis showed a potential IUSF funding support requirement of over $24 million for the IITA Member Intervenors as a group. This demonstrates that the "economic cost" exceeds the proposed affordable rate and the federal support for the companies as a whole. It further demonstrates that using the proxy cost approach as contained in the statute, the IITA Member Intervenors, as a group, would be eligible for receiving that amount of IUSF funding and that each company should be eligible for such funding. (IITA Exhibit 3.0 at lines 364-387)

The $19 million funding requested, however, is less than the $24 million supported by the economic cost model proxy results for the IITA member companies as a whole. (*Id.* at 384-387) Consistent with the Commission Orders in the Prior Consolidated Dockets, with the Stipulation and Agreement and with the Consensus Position, the IITA is not proposing to use the HAI to set the ultimate size of the fund. Rather, the IITA is proposing to cap the recovery for each of the Member Intervenors based on a determination of the actual need for each, based on calculation set forth in a Schedule 1.01. (Joint draft order at 22-23)

The Schedule 1.01 analysis is the result of the Commission's November 21, 2000 *First Interim Order* in the Prior Consolidated Dockets, in which the Commission expressed its intent that IUSF funds should not be provided to companies until some type of showing is made that the company is "in need" of receiving such funding. The IITA used a similar process in developing its request for an update to the IUSF and subsequently engaged in negotiations with AT&T Illinois on that basis, leading to the Stipulation and Agreement. Through testimony, changes made over the course of this docket and the Consensus Position it reached with IITA, Staff agreed with this approach for the limited purposes of establishing this interim update to the IUSF (and subject to one material difference to the Schedule 1.01s related to the S corporation status of certain IITA Member Intervenors). (*Id*. at 23)

As the record in this docket currently stands, "the IITA has demonstrated that the economic cost of providing service (taking into account federal USF) exceeds the affordable rate." (*Id*.) Moreover, each of the Small ILEC Intervernors has completed its own Schedule 1.01 analysis reflecting its individual company need as a cap on its IUSF request, and updated that analysis over the course of this docket to respond to questions or criticisms raised by Staff or the other parties. The totals from those individual company Schedule 1.01s are reflected in two different IITA exhibits. IITA Exhibit 5.10 reflects the IITA's updated fund size of $19,130,125 (or $19,717,158 when Frontier's request is included). This Exhibit reflects not only the overall fund size, but the updated amount of funding for each of the IITA Member Intervenors. Those individual company entries match Staff's estimated fund size for all but five IITA Member Intervenors, each of which is an S corporation.

B. Staff Position

In light of the fact that the IUSF provides a subsidy to eligible carriers constituting the difference between the cost of providing service and the Commission-established affordable rate, less federal support received for providing the same supported services, 220 ILCS 5/13-301(1)(d), any changes to the federal support scheme necessarily affect the size of the IUSF. As the FCC Report and Order freezes some federal support mechanisms, phases out others entirely, and adopts a regime that will result in other issues remaining undecided for some time, setting the IUSF fund size now on a permanent basis would not be a suitable use of the parties' or Commission's resources. Establishment of an Interim fund is therefore appropriate at this time. (Staff IB at 7)

Most of the parties have reached a consensus regarding the establishment of an interim fund on four main points, as outlined in Staff Exhibit 4.0 and as identified above.

In Staff's view, the Commission should accept the recommendations of the general Consensus Position reached by the parties in this matter, as outlined in the four points above. (Staff IB at 14)

Staff's position is further described below under "Staff Response to CT&C."

C. AT&T Illinois Position

Docket No. 11-0211 was initiated by the IITA's filing of a Petition asking the Commission to adopt a Stipulation and Agreement between the IITA and AT&T Illinois. The Stipulation provided for a review and update of the IITA carriers' current Illinois USF high cost support, using an updated forward-looking HAI Cost model combined with a rate of return review (Form 1.01). This methodology had been used previously to establish the IUSF in Consolidated Docket Nos. 00-0233/0335 ("*the 00-0233 Proceeding*"). Under the proposed Stipulation and Agreement, the IUSF-funded companies would utilize the updated Form 1.01 based on 2009 data to establish a need and their individual qualification for IUSF support. In calculating the increased amounts of support sought, the IITA utilized as inputs: 1) 2009 financial results with adjustments for 2010; 2) an after-tax cost of capital of 12.60% for telephone cooperatives or 11.21% for small commercial companies, and 3) an affordable rate of $20.39 per month, which was the affordable rate established in the 00-0233 Proceeding. (AT&T Illinois IB at 1-2)

As it related to high-cost support, the Stipulation: 1) included a modification to the original Form 1.01 that provided for an adjustment to the IITA carrier's network costs to address the impact of the lag in federal USF ("FUSF") support; 2) did not guarantee recipients IUSF support based on a level of rate of return ("ROR") used in the 00-0233 USF proceeding; and 3) provided for adjustments to deal with broadband costs reported by the carrier, if the carrier's data did not comply with the Federal Communications Commission's cost allocation methodologies regarding broadband costs.

The Stipulation also included a provision that the participating IITA carriers would adjust their intrastate originating and terminating switched access rates to levels that would mirror their respective interstate switched access rates and structure, upon entry of a Commission Order approving the Stipulation and Agreement. The HAI Cost Model was then used again to determine the legislatively-permitted proxy cost and to determine the amounts of subsidy in switched access rates. The Stipulation provided for the creation of an access restructuring element in the IUSF that would have enabled the IITA companies to receive explicit support for the decreases in revenue that would result from the reductions in their intrastate access rates. (AT&T Illinois IB at 2-3)

The methodologies outlined in the Stipulation and Agreement were consistent with those previously adopted by the Commission in its prior Orders in both the 00-0233 proceeding and in Alhambra-Grantfork Telephone Company Petition for Universal

Service Support in Docket No. 04-0354. While AT&T Illinois did not necessarily agree with the methodologies adopted in the 00-0233 proceeding, the use of the 00-0233 USF methodology in this proceeding provided a reasonable result within the context of the Stipulation and Agreement and permitted the IITA participants to obtain the additional funding, which the IITA indicated was needed. (*Id.* at 3)

While the original Stipulation identified a $10.4 million funding replacement mechanism for mirroring intrastate switched access rates and structure with the interstate rates and structure, Staff and others objected to a one-to-one replacement mechanism for anticipated lost access revenues. (Staff Ex. 1.0 at 6-7; Staff Ex. 3.0 at 18) Acknowledging the requirements of Section 13-301(2)(b) and recognizing the need for revenue stability during the time of transition to full mirroring of interstate switched access rates, a suitable replacement mechanism for the reduction in intrastate switched access was identified. This approach combined the historically-established funding calculation from the Form 1.01 with the recognition that interstate switched access mirroring will result in reduced revenue for the associated companies. (AT&T Illinois IB at 4)

The participating IITA companies determined the impact of mirroring intrastate access rates and structure to determine the historical revenue impact on 2009 intrastate switched access revenues. Using 2009 revenue, expense and switched access data, each individual company provided an updated Form 1.01 that incorporated this revenue difference to ultimately determine the funding levels for participating companies. (IITA Ex. 3.0, p 2; IITA Ex. 3.4) This approach complies with the requirement in Section 13-301(2)(b) of the Illinois Public Utilities Act ("PUA") that the Commission "[i]dentify all implicit subsidies contained in the rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund." (AT&T Illinois IB at 4)

Section III of AT&T's initial brief is titled, "The Impact of the FCC's *ICC/USF Order*." On November 18, 2011, after the second round of testimony had been submitted in the instant proceeding, the FCC released its *ICC/USF Order* addressing significant universal service and intercarrier compensation reforms. In summary, the order adopted a uniform national bill-and-keep framework for all telecommunications traffic exchanged with a LEC. As of the effective date of the FCC's order, all access (for non-local calls) and reciprocal compensation (for local calls) rates were capped, except for originating intrastate access charges for rate-of-return ("ROR") ILECs (which would include the IITA companies) and those CLECs which benchmark to those ILECs' rates. (AT&T Illinois Ex. 2.1 at 2-3)

That order established a six-year phase-down to bill-and-keep for terminating access and reciprocal compensation rates for price cap carriers. ROR carriers' rates are subject to a nine-year phase down schedule. (*Id.* at 3) "Bill and Keep" is a term which describes an intercarrier compensation arrangement resulting in a compensation level of zero. Under "bill and keep" arrangements, providers recover their network costs

from their own customers (e.g., end-users) rather than from other carriers. (AT&T Illinois IB at 5)

The FCC's *ICC/USF Order* had an immediate effect on intrastate switched access rates. For price-cap carriers and CLECs that benchmark to their rates, the FCC ordered, that as of the effective date of its new rules, "all intercarrier switched access rate elements, including interstate and intrastate originating and terminating rates and reciprocal compensation rates are capped." *FCC ICC/USF Order*, ¶801. Similarly, the terminating and reciprocal compensation rates of ROR carriers and those CLECs which benchmark to their rates are capped. However, the originating access rates for ROR carriers and those CLECs which benchmark to their rates were not capped. Capping such rates did not mean that the FCC froze the rates. Rather, it meant that state Commissions may not permit carriers to raise those rates. Significantly, the FCC did not preclude states from lowering such rates. The *ICC/USF Order* adopted a Further Notice of Proposed Rulemaking ("FNPRM") seeking comments on the appropriate transition for originating access and transport rate elements, and interconnection issues. (AT&T Illinois IB at 5-6)

Section IV of AT&T's initial brief is titled, "The Commission Should Adopt the IITA Proposal to Reduce Originating Switched Access Rates for All IITA Members that are Part of this Proceeding." The original Stipulation and Agreement provided that the IITA members who signed on to the Stipulation and Agreement reduce both their intrastate originating and terminating switched access rates and rate structure to mirror their respective interstate levels. In light of the FCC's *ICC/USF Order*, the IITA amended the switched access proposal that was part of the Stipulation and Agreement. (IITA Ex. 3.0 at 6) The IITA's revised proposal deferred to the FCC's schedule for reducing interstate terminating access, but advocated the reduction of originating intrastate switched access rates immediately upon entry of an Order by the ICC. This revised proposal for the reduction of originating switched access charges was also supported by the Frontier Companies. (AT&T Illinois IB at 6)

In AT&T Illinois' view, the Commission should adopt the IITA's proposal to reduce originating switched access rates to interstate levels for several reasons. First, mirroring requirements are appropriate from a policy perspective because where switched access rates are higher in one jurisdiction (intrastate) than another (interstate), market participants may engage in regulatory arbitrage to take advantage of the differences in rates. (AT&T Illinois Ex. 2.0 at 7-10) Also, high switched access rates result in higher toll rates which lead consumers to seek providers who are not burdened by such high costs. Thus, from a policy perspective it makes sense to AT&T Illinois to require carriers to mirror their interstate switched access rates and rate structure. (AT&T Illinois IB at 6-7)

Second, mirroring is consistent with requirements that the Illinois legislature has already imposed on most other carriers in Illinois. Under revisions to the PUA that became effective in 2010, any telecommunications carrier electing market regulation was required to reduce its intrastate switched access rates to levels that mirrored the

rates and rate structure of its interstate switched access rates no later than June 30, 2013. 220 ILCS 5/13-506(g)(l). The PUA also requires ILECs serving more than 35,000 access lines and CLECs to mirror their interstate access rates by July 1, 2012. 220 ILCS 5/13-900.2. Although Section 13-900.2 does not apply to the IITA companies as ILECs serving 35,000 or fewer access lines, the IITA members' agreement in the Stipulation and their amended testimony to reduce their intrastate switched access rates to interstate levels is consistent with the Illinois legislature's determination that mirroring is good public policy. (AT&T Illinois IB at 7)

Another reason why the Commission should adopt the agreement to reduce originating switched access is that the FCC's *ICC/USF Order* expressly permits states to reduce intrastate switched access rates beyond what the FCC required. The *ICC/USF Order* states, "To the extent that states have established rate reduction transitions for rate elements not reduced in this order, nothing in this order impacts such transitions … nor does this order prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed as a result of a faster transition." ¶816, fn.1542.

Thus, AT&T Illinois argues, nothing in the FCC's Order precludes the Commission from adopting the IITA members' proposal to reduce originating switched access rates. (AT&T Illinois IB at 7)

Finally, the IITA's proposal to reduce originating switched access charges is permissible under Section 13-301(2)(b) of the PUA which requires that in establishing a USF, the Commission must identify the implicit subsidies in the rates of incumbent local exchange carriers and make them explicit. (AT&T Illinois IB at 9-10) AT&T Illinois' witness addressed why reducing intrastate switched access rates is consistent with that requirement. He explained in his testimony:

> By reducing intrastate switched access rates to the level of the corresponding interstate switched access rate, the Commission will be identifying and removing much of the implicit subsidies inherent in the intrastate switched access rates of the participating companies. By allowing for the recovery of the revenue reductions resulting from the elimination of those implicit subsidies, the Commission will be making those implicit subsidies explicit in accordance with Section 13-301(2)(b) of the Illinois Public Utilities Act. (AT&T Illinois Ex. 2.2 at 5)

In its reply brief, AT&T Illinois asserts that the Stipulation closely tracks federal and state policy. The FCC's order adopts substantial reductions to terminating access rates – in fact, those rates will be phased down to zero. The Stipulation here simply provides additional benefits by proposing more modest reforms on the originating access side. The FCC's order expressly invites the states to adopt such additional reforms, and it also encourages carriers to implement reforms by agreement as the parties here have done. *ICC/USF Order*, ¶ 739 and ¶ 816 n.1542. (AT&T Illinois RB at 3)

The Stipulation tracks the shared federal and state policy in favor of replacing implicit subsidies with explicit support. By reducing originating switched access charges, it will reduce the implicit subsidies buried in those charges. In place of those implicit subsidies, the small rural carriers entering the Stipulation will be eligible for explicit universal service support that is spread out more widely, and on a more competitively neutral basis, than switched access charges are. That said, the support will not be handed out automatically to carriers reducing their access charges. Rather, a carrier must make a showing that they need support before they receive funding. The reduction in access charges is simply the upper limit on the support they can receive, so the program operates under responsible budget constraints. (AT&T Illinois RB at 3-4)

Section II of AT&T Illinois' reply brief is titled, "The Stipulation is Fully Consistent with the FCC's Order and the General Assembly's Mandates." The FCC recognized that the old regime of "hidden, inefficient charges" has been "unfair" to the "hundreds of millions of Americans" who have been "paying more on their wireless and long distance bills than they should." *ICC/USF Order*, ¶ 9. Further, "the system is eroding rapidly as consumers increasingly shift from traditional telephone service to substitutes including Voice over Internet Protocol (VoIP), wireless, texting, and email." *Id.* "As a result, companies' ICC [intercarrier compensation] revenues have become dangerously unstable, impeding investment, while costly disputes and arbitrage schemes have proliferated." *Id.* All of these problems stem from the underlying fact that the existing access charge regime is "outdated, designed for an era of separate long-distance companies and high per-minute charges, and established long before competition emerged among telephone companies, cable companies, and wireless providers for bundles of local and long distance phone service and other services." *Id.* (AT&T Illinois RB at 6-7)

Disparities between interstate and intrastate rates create still more problems. As the FCC noted, some states have implemented parity between interstate and interstate rates, but "[i]n many states, intrastate rates are significantly higher than interstate rates." *ICC/USF Order*, ¶ 791. These "varying rates have created incentives for arbitrage and pervasive competitive distortions within the industry." *Id.*

While intrastate originating access rates should be reduced to mirror the corresponding interstate rates, it is still important to remember that those access rates were intended to advance the good end of promoting affordable universal service, particularly in high-cost rural areas. A rural carrier's rate structure for retail local service may not be sufficient to cover its cost if its implicit subsidies are reduced. If the affected LECs have to recover access reductions by increasing the rates they charge their end users, consumers could experience rate shock; meanwhile, forcing the LECs to subsidize their high-cost customers with revenues from lower-cost areas or other services would just create another unsustainable implicit-subsidy regime. To protect against such results, the Stipulation provides that the participating IITA members would be eligible to receive explicit support from the Illinois Universal Service Fund. (AT&T Illinois RB at 8)

Such explicit support mechanisms are fully consistent with federal and state policy. Section 13-301(1)(d) of the Public Utilities Act authorizes the Commission to establish universal service funds and directs the Commission to "[i]dentify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit." The FCC has rebalanced past reductions in interstate access rates in large part by using explicit support mechanisms. The FCC's recent *ICC/USF Order* continues this policy by establishing a new explicit support fund so carriers can recover part of the revenues that will be lost due to the FCC-ordered reductions on the terminating access side. (*Id.*)

The parties revised the Stipulation to take full advantage of the federal recovery mechanisms established by the *ICC/USF Order*, and to address Staff's concerns about dollar-for-dollar replacement of access reductions. The original Stipulation was designed to reduce intrastate access rates on the originating and terminating side, and it identified a $10.4 million funding replacement mechanism. Now that the FCC has addressed reductions on the terminating side, and established federal recovery mechanisms for those reductions, the upper limit on the explicit support from the IUSF has been "greatly reduced," to a ceiling of $2.88 million. (*Id.* at 9-10)

D. Frontier Position

Frontier includes eight small incumbent local exchange carriers ("ILECs") in Illinois that are eligible to qualify for receipt of funding, and in fact received IUSF support pursuant to the Commission's Twenty-Seventh Interim Order in Docket No. 83-0142. Currently, as a result of orders issued in Docket Nos. 00-0233 and 00-0335, only Frontier Communications of Illinois, Inc., Frontier Communications – Midland, Inc. and Frontier Communications – Schuyler, Inc. receive annual IUSF support as a result of the current funding mechanism. In the aggregate, these companies receive $467,612 in annual IUSF support. (Frontier IB at 3-4)

Among other things, Frontier also conducted a "Form 1.01" rate of return analysis, which included adjustments for "normalizing" 2009 federal USF support, imputing revenue if rates are below the affordable rate level of $20.39 and anticipating loss of originating intrastate access revenue resulting from mirroring interstate access rates. Based on the adjusted Form 1.01 rate analysis, the Current Eligible Frontier Companies have aggregate revenue deficiencies of $3,365,020.

In Frontier's view, its analysis establishes that the Current Eligible Frontier Companies are entitled to a continued level of IUSF support in excess of the $467,612 being received by only three Frontier companies today. (*Id.* at 4-5)

On an Interim Basis Only, Frontier Agrees to Annual Cap of IUSF Support. Based on the assumption that what is being proposed is an IUSF update until initiation and resolution of a more comprehensive investigation into IUSF, Frontier is agreeable to

an annual level of IUSF funding at the existing annual support level of $467,612 plus recovery of its originating intrastate access revenue loss from mirroring originating interstate access rates, calculated at $119,421 annually, for a total annual level of IUSF support of $587,033. (*Id*., citing FC Ex. 2.0 at 15-17) Frontier also proposes to allocate this $587,033 annual amount among the Current Eligible Frontier Companies as reflected in the chart found at line 367 of the Supplemental Direct Testimony of Jack D. Phillips. (FC Ex. 2.0) Neither AT&T nor IITA object to Frontier's request for this annual funding pending conclusion of the anticipated, and requested, separate Commission proceeding to be initiated on IUSF. Frontier also states that continued receipt of IUSF of $467,612 is supported by the testimony of Staff Witness Mary Everson. (Frontier IB at 5)

Frontier suggests that the Commission initiate a new docket through which it conducts a thorough evaluation of the IUSF funding mechanism considering developments at the FCC as well as Illinois public policy goals related to voice and broadband services. In the meantime, Frontier requests that the Commission order an update to the IUSF in this proceeding, utilizing the general framework reflected in the First Amended Stipulation and Agreement filed by IITA (IITA Ex. 1.02), subject to the approval of an annual level of IUSF support of $587,033 as described above. (*Id.* at 3)

E. CT&C Position

CT&C takes no position regarding the IITA's request for an increase in the IUSF regarding basic elements. However, CT&C maintains that the IITA/AT&T Illinois "additional proposal," to further increase the IUSF to recover the reduced ILEC revenues resulting from a lowering of intrastate originating access rates, is inconsistent with and contrary to the public policy determinations made by the FCC and the Illinois General Assembly for balancing the transition of access charge reform with the provision of universal service. (CT&C draft order at 1)

According to CT&C, in the *USF/ICC Transformation Order* the FCC established a nationwide transition plan for the reformation of all access charges, intrastate and interstate, origination and termination, for price cap, rate-of-return and competitive LECs. Concluding that the access charge regime should transition to a bill-and-keep relationship, the FCC reviewed competing proposals as to how to best transition from the current access charge structure while balancing these changes with the policy goals for the provision of universal service. While the FCC's interim treatment of intrastate originating access for rate-of-return ILECs, such as the IITA members, in this transition comports with the similar treatment accorded by the Illinois statutes, it differs significantly from that proposed by IITA/AT&T Illinois. (*Id.*)

CT&C submits that the FCC recognized both the potential impact the disruption of revenues would have on carriers and the additional burdens that could be placed on consumers by shifting the revenue recovery on them. To balance the dual policy goals of access charge reform and universal service, the FCC determined to initially address terminating access while imposing interim reform to originating access. The FCC stated

that this is due in large part to its intent to avoid increasing the universal service fund size to replace the reduced revenues resulting from the access charge transition.

By initially reducing only terminating access rates, the FCC addressed the largest subsidies and arbitrage concerns. In capping interstate originating access, and not restricting intrastate originating access charges for rate-of-return LECs, the FCC seeks to enable them to realize the necessary revenues for the transition while avoiding additionally burdening consumers with increased universal service charges. In reaching this conclusion, the FCC noted AT&T's FCC comments which urged the position to not make any changes in originating access rates at this time in the transition. (*Id.* at 1-2)

CT&C also asserts that the Illinois General Assembly came to the same determination as the FCC. Section 13-900.2 of the Act requires other carriers' intrastate access rates to mirror their interstate access rates, but expressly exempts the ILECs of less than 35,000 access lines, which includes the IITA members. This recognizes the small ILECs' need for such revenue stream without upsetting other charges. CT&C submits that the IITA/AT&T Illinois proposal contradicts this balanced approach.

CT&C further argues that the methods proposed by IITA/AT&T Illinois to reduce the intrastate originating access rates and to increase the universal service fund have been rejected by the FCC and the Illinois legislature. In addition to the FCC's determination to prevent the access reform transition from increasing the burden on the universal service fund, the FCC rejected the proposal that the access charge transition should be revenue neutral. The FCC further recognized the need to reduce the access rates over a period of years to provide a transition glide path enabling the carriers time to adjust their operations. CT&C observes that the FCC noted AT&T's support for both of these positions. (CT&C draft order at 2)

Section 13-900.2 of the Illinois Act also does not provide for a revenue neutral recovery of the access charge reductions, and further provides for a multi-year transition period for those carriers required to have intrastate access rates mirror interstate access rates. In contrast, the IITA/AT&T Illinois proposal calls both for revenue neutrality and for an immediate "flash cut" in originating access rates upon the entry of the order in this docket. CT&C maintains that these methods have been expressly rejected by the FCC on policy grounds and are contrary to the methods adopted by the Illinois legislature. (*Id.*)

CT&C submits that the IITA/AT&T Illinois proposal ignores the FCC and the Illinois statutes determinations to balance (1) the transition of access charges, (2) the revenue needs of the rate-of-return ILECs, and (3) the burden on consumers in supporting universal service, by only addressing (1) the AT&T Illinois request for lower access rates and (2) the IITA's revenue requests, while ignoring (3) the burden on the consumer of the increase in universal service charges. (*Id.*)

Finally, CT&C notes that the FCC will be issuing originating access charge reform requirements through its current Further Notice of Proposed Rulemaking that will be binding upon the states. Other state commissions have noted this and have declined to institute local originating access requirements that will only need to be recalled and amended once the FCC has issued its transition requirements. CT&C recommends that the Commission do likewise.

CT&C submits that the IITA/AT&T Illinois revenue recovery proposal to increase the IUSF by $2,881,511 to offset a reduction in originating access rates should be rejected. The FCC's transition plan should be followed and changes to the small ILECs originating access rates should not be required at this time. (*Id.*)

CT&C's recommended "analysis and conclusion on originating access" are contained in Section XX of its draft order.

According to CT&C, all parties recognize that the industry is involved in a restructuring of previous carrier relationships including the restructuring of intercarrier compensation. This concern has occupied both the attention of the FCC and the states. The issue is not whether the access rate structure will change but what is the best approach to accomplish the transition. A significant part of the complexity is the interrelationship between intercarrier compensation and universal service, both critical policy considerations for the FCC and for the Commission. (CT&C draft order at 3)

IITA and AT&T Illinois submitted that the FCC had long promised to address intercarrier compensation issues but failed to do so. That instigated the current IITA/AT&T Illinois proposal for intrastate access rate changes for the IITA members. However, during this proceeding the FCC did act and issued its long awaited *USF/ICC Transformation Order*, with the FCC's plan for intercarrier compensation reform and universal service. AT&T Illinois and IITA argue that the FCC only provided a "transition plan for terminating access," leaving any transition for intrastate originating access up to the states. That is only partly accurate. As noted by CT&C, the FCC did determine how to treat originating access, explicitly addressing how to treat intrastate originating access for rate-of-return LECs such as the IITA members, at this point in the access reform transition. The problem for the IITA/AT&T Illinois proposal is that the FCC came to "exactly the opposite conclusion" as to how to do it. (*Id.*)

Contrary to the claims of some parties, CT&C has not argued that the Commission has been preempted from dealing with intrastate originating access. The FCC expressly permitted the states to cap intrastate originating access for rate-of-return carriers, but they must do so in a manner that promotes the goals of the FCC's comprehensive plan. Instead, CT&C has pointed out that the IITA/AT&T Illinois proposal contradicts the policy determinations made by the FCC as to how to address intrastate originating access during the transition. CT&C further argues that the FCC's policy determinations are consistent with the approach taken in the Illinois Act.

Accomplishing a reduction in access rates is expected to result in a reduction in revenues for the LEC. This impacts the ability of that LEC to maintain rates for basic service at a level that will promote universal service. Wrestling with this dynamic, the FCC determined that terminating access rates are the largest source of implicit subsidies and potential arbitrage. Therefore the FCC determined that a reduction in terminating access rates is the first step needed to be addressed in reforming intercarrier compensation.

To avoid simply shifting that revenue burden onto other rates, the FCC provided a timetable of between six and nine years for carriers to reduce their terminating access rates and to adjust to the transition. The FCC expressly determined that it did not want to increase the universal service fund to compensate for the reduction in access revenues and further rejected the proposal that the transition should be revenue neutral. Instead it presented a "transitional glide path" over a number of years to provide the carriers with time to adjust in the marketplace with "greater efficiencies, not greater USF support." (CT&C draft order at 3-4)

To support this major transition of intercarrier compensation while not increasing the burden on consumers through increased USF fees, the FCC determined that originating access rates would not be reduced at this time. Although originating access would ultimately transition to bill-and-keep like terminating access, the FCC found that the LECs would need the current originating access revenues at their disposal while transitioning the terminating access rates without increased USF support. Therefore, the FCC decided to simply cap originating access rates for the moment. However, for the small rate-of-return LECs, like the IITA members, the FCC made an "explicit exception" allowing them to even increase their intrastate originating access rates expressly for the reason that they may need those revenues to be available to maintain universal service. Therefore, the FCC transition plan clearly considered the treatment of intrastate originating access during the transition and determined how it should be best addressed within the overall plan of intercarrier compensation reform, balancing those policy goals with those for the provision of universal service. (*Id.* at 4)

CT&C urges the Commission to find the FCC's approach to be consistent with the access compensation reforms found in the Act. In Section 13-900.2 the Illinois legislature also provides for a reduction in access rates over a transition period of a number of years, enabling the carriers time to adjust. There is no provision for revenue-neutral recovery for the carriers' access rate reductions. And in particular, the General Assembly expressly exempted the small ILECs of less than 35,000 access lines from reforming their intrastate access rates to mirror their interstate access rates as proposed by IITA/AT&T Illinois. This implicit recognition by the legislature of the particular needs of these small ILECs for this revenue corresponds to the findings of the FCC. (*Id.*)

AT&T Illinois and IITA argue that Section 13-301(1)(d) of the Act providing for the IUSF supports their proposal. This section references Section 13-301(2)(b) which provides that in creating the IUSF the Commission should identify all implicit subsidies

contained in the rates and charges of the ILEC, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund. However, this provision provides for a complete analysis of the implicit subsidies in all of an ILEC's rates and charges, not just in the originating access rates as in the IITA/AT&T Illinois proposal. There has been no showing in this record of any attempt to identify all of the implicit subsidies in the rates and charges of any of the IITA's members.

AT&T Illinois also argues that the FCC permits parties to enter into negotiated agreements for rates that differ from the FCC order. However, an agreement between AT&T Illinois and the IITA members for different access rates is not the issue being contested. The issue is the supplemental request to have a third party, the consumers, burdened with additional IUSF support to make the rate reduction revenue neutral. Consumers were not a party to this negotiation or to this agreement. It is this fundamental element, the potential for an additional burden on the USF to replace reduced access revenues, that the FCC specifically addresses in its balanced transition plan treatment of originating access and that the IITA/AT&T Illinois proposal violates. (CT&C draft order at 4-5)

Staff argues that the changes in the IITA/AT&T Illinois proposal, from one providing for a separate originating access charge element that directly captures the revenue recovery of the access charge reductions to one incorporating the additional revenue needs of the IITA members in their Schedule 1.01 resulting from their originating access rate reductions, is distinct from a revenue neutral requirement.

CT&C responds, "But for a small ILEC, that already claims to have insufficient IUSF support to maintain the Commission determined affordable rate for universal service, to reduce its originating access revenues by any amount and to include that same amount of revenue reduction in its Schedule 1.01, necessarily increases its IUSF request by the same dollar for dollar amount that it reduced its originating access rates. That is the definition of revenue neutrality, a policy that the FCC has rejected." (*Id.* at 5)

CT&C further argues that the voluntary reduction in originating access rates, only to increase the IUSF by a like amount, violates the intent, if not the letter, of Section 13-301(2)(c) which prohibits the lowering of rates in effect at the time the fund is created.

In CT&C's view, the Commission need not decide that issue. When dealing solely with the issue of access charge reform, the Act's direction in Section 13-900.2 is more specifically on point and consistent with the national approach designed by the FCC that balances all of the policy considerations regarding the transition of intercarrier compensation and the maintenance of universal service. (*Id.)*

As a result of its Further Notice of Proposed Rulemaking, the FCC will be announcing a national plan governing the transition of intrastate originating access to a bill-and-keep methodology, balanced with the policy needs for universal service that will be binding on all of the states. With the current transition reforms being implemented

for terminating access, and with the adjustments to the IITA's members IUSF requests being made in this order, CT&C urges the Commission to agree with what CT&C characterizes as the FCC's determination to not require additional changes to intrastate originating access at this time. These revenues will be needed by small ILECs during the other transitions, as found by the FCC, as contemplated by the Act, and as confirmed by the IITA/AT&T Illinois proposal itself. Not making further access rate adjustments will lessen the additional burden being imposed on consumers by the increases resulting in the support for basic elements. CT&C urges the Commission to agree with the other state commissions that, with further action being contemplated by the FCC on originating access charges, it would be "rash" for this Commission to take any further steps at this point in time to address the issue. (*Id.)*

In conclusion, CT&C argues that the "IITA/AT&T Illinois proposal to add $2,881,511 to the IUSF support to replace the proposed reduction in IITA members' intrastate originating access rates [should be] denied." CT&C suggests the Commission further find, "Consequently, there will be no requirement for IITA members' intrastate originating access rates to mirror their interstate originating access rates to receive the IUSF support otherwise provided herein." (*Id.)*

F. Response to CT&C

1. IITA

The Cable Association intervened in this docket at the "eleventh hour" to object to any provision for the mirroring of intrastate originating switched access charges, despite the fact that mirroring has been an issue in this case since the original Petition was filed in March of 2011. (Joint draft order at 32) In raising this issue, however, the Cable Association "mischaracterizes the FCC's *ICC/USF Transformational Order* and the current proposal in this docket." *(Id.)*

Originally, the IITA and AT&T had proposed a two-part update to the IUSF, one element to update the basic elements of the IUSF and the second element to allow the IITA Member Intervenors to reduce their intrastate switched access rates to mirror their interstate switched access rates while receiving dollar for dollar replacement support. Although the Cable Association "ignores it," since the filing of the initial Petition, the IITA's proposal changed in two very material respects. First, Staff not only advocated the mirroring of intrastate switched access charges; it contended that the Commission could insist on switched access mirroring as a condition for companies participating in an updated IUSF. (IITA draft order at 32-33, citing Staff Exhibit 1.0 at lines 267 271) But Staff objected to the proposal for a separate access restructuring element of the IUSF and dollar for dollar replacement. Rather, Staff insisted that the impact of mirroring should be reflected in the Schedule 1.01 needs showing, along with all other costs and revenues of providing a level of telephone service that met the carriers' universal service obligations. (*Id.* at 33)

Both of these Staff positions are included in Paragraph 2 of the Consensus Position:

> The Interim Fund should be based upon an updated "need showing" using the Schedule 1.01 methodology used by the Commission in establishing the original IUSF effective October 1, 2001. That analysis and showing will also incorporate the affect of all companies seeking and qualifying for the Interim Fund reducing originating intrastate switched access charges to "mirror" originating interstate switched access charges contemporaneous with the effective date of the Interim Fund.

The IITA's original proposal was also changed insofar as the number of intrastate switched access minutes was roughly cut in half when the FCC issued its *ICC/USF Transformational Order*. That Order removed intrastate terminating switched access from the instant ICC proceeding, by "requiring on the federal level mirroring (as the IITA was proposing in this docket) and providing a federal recovery mechanism." (IITA draft order at 33) As a result of the *ICC/USF Transformational Order*, intrastate terminating switched access is no longer a subject of this docket and any resulting revenue shortfalls are not reflected anywhere in the updated IUSF. Finally, the recovery sought was also reduced in response to Staff's recommendation that the IITA use 2009 intrastate switched access minutes to benchmark lost revenues instead of 2008. (*Id*.)

Thus, only intrastate originating switched access remains, and it is benchmarked from 2009. Also, at Staff's insistence and consistent with the Consensus Position, the impact of mirroring intrastate originating switched access has been treated as a revenue reduction in the Schedule 1.01s supporting basic IUSF. As Staff witness Dr. Zolnierek stated, "Rather than creating a separate access element, the Companies have agreed to follow the administrative procedure I recommended." (Joint draft order at 33, citing Staff Exhibit 6.0 at lines 323-324) This is a very different proposal than what the IITA initially advocated and the one the Cable Association criticizes.

The IITA asserts that the Cable Association mischaracterizes the FCC's *ICC/USF Transformational Order* insofar as it claims that the FCC has preempted this Commission's authority to act on intrastate originating switched access charges. "Specifically, footnote 1542 to Paragraph 816 of the *ICC/USF Transformational Order* preserves the ability of state commission to reduce rates on a faster transition provided that state provides any additional recovery support that may be needed as a result of a faster transition." (*Id*. at 34) According to the IITA et al., the Consensus Position for an interim update to the IUSF, particularly as that proposal was modified by Staff, meets both conditions of the italicized quotation from footnote 1542. It will reduce intrastate originating switched access rates faster than is called for by the *ICC/USF Transformational Order* and it provides as part of the state USF program the additional recovery support needed as a result of the faster transition. Contrary to the implications of the Cable Association, the *ICC/USF Transformational Order* does not compromise this Commission's authority to implement the interim update to the IUSF as supported by the IITA, Staff, Frontier and AT&T Illinois. (*Id*.)

The IITA also asserts that the Cable Association mischaracterizes the current proposal. As discussed above, the initial Stipulation and Agreement submitted by the IITA and AT&T Illinois did propose a separate element of the IUSF to recover on a dollar for dollar basis what the IITA Member Intervenors would have lost by mirroring the intrastate switched access rates. As a result of Staff's insistence that the revenue shortfalls, benchmarked from 2009, simply be rolled into the basic Schedule 1.01 process (not to mention the removal of intrastate originating switched access), the IITA's proposal has changed very significantly.

Because of that change, the Cable Association either "misunderstands or misstates" the record when it asserts that the inclusion of access mirroring will add $2,881,511 to the cost of the IUSF. That number, drawn from IITA Exhibit 3.3, represents the revenue shortfall to the IITA Member Intervenors from mirroring originating intrastate switched access to their corresponding interstate rates. As a result of the Staff's modification, that $2,881,511 is not recovered on a dollar for dollar basis. Rather, the shortfall for each of those individual companies is counted into their respective company Schedule 1.01s, along with all of the company's other costs and against all of the company's revenue sources. Therefore, "it would be incorrect to assert, as the Cable Association does (e.g., Initial Brief at 12 and 14), that the Consensus Position results in a 'revenue neutral' transition for intrastate originating switched access for the IITA Member Intervenors." (IITA draft order at 34) The consequence of mirroring intrastate originating switched access is simply treated as another known and measurable financial impact, subject to a needs based showing through the Schedule 1.01 process.

The Schedule 1.01 process coordinates each company's need with the Commission-established affordable rate to the customers. By ignoring this, the Cable Association "completely misses the point of the IUSF" in saying the IITA Member Intervenors should look to their own customers before looking to a universal service fund. (*Id*.) Each of the IITA Member Intervenors is already charging its own customers at least the affordable rate (or imputing the difference for IUSF purposes). The Schedule 1.01 shows that, with at least the affordable rate being paid by local customers (and taking into account all other existing forms of revenue), the IITA Member Companies cannot provide service at a reasonable rate of return because they serve low density, high-cost areas. Absent IUSF, the investment necessary to provide service to these rural customers would dry up, undermining the very purpose of "universal" service. The Cable Association's "reflexive demand" that these companies simply look back to their customers ignores the purpose of universal service and the evidence in this docket. (*Id.*)

Finally, the Cable Association notes that the FCC is still working on how to handle federal USF and intercarrier compensation reform for smaller rate of return carriers through its further notice of proposed rulemaking issued along with the *ICC/USF Transformational Order*, and suggests that this Commission should not expend resources until the FCC finalizes its transition in all respects. According to IITA

and other filers of the joint draft order, "The record in this docket, however, demonstrates that the FCC has been saying for years that it would complete this process with less than encouraging results about its ability to accomplish this. The IUSF is in need of updating now and the Consensus Position among the IITA, Staff, AT&T Illinois and Frontier clearly acknowledges the need, following an update, to review the entire format of the IUSF in light of future FCC actions." (Joint draft order at 35)

2. Staff Response to CT&C

CT&C recommends that the Commission "deny the proposal by the Illinois Independent Telecommunications Association and Illinois Bell Telephone Company to the extent that it requests an increase to the Illinois service fund to recover revenues resulting from a decrease in intrastate access rates." (CT&C IB at 20) Staff recommends that the Commission reject this recommendation. (Staff RB at 8)

Section 13-301(2)(d) directs the Commission when creating the universal service fund at issue here to: "Identify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund." 220 ILCS 13-301(2)(d).

As noted by Staff witness Dr. James Zolnierek, "the HAI based estimates submitted by IITA indicate that intrastate switched access revenues for the companies exceed intrastate switched access costs." (Staff Ex. 2.0 at 20) Therefore, if current switched intrastate access revenues and costs are included in the rate of return based determination of need being proposed to establish funding levels, it follows that they serve to reduce any revenue shortfalls incurred in the provision of basic local exchange service. In such circumstances, these intrastate access revenues implicitly cross-subsidize basic local exchange service. In his testimony, Dr. Zolnierek recommended that "[t]he Commission could eliminate the bulk of such cross subsidies … by requiring, as a condition of receiving IUSF funding, that providers reduce their intrastate switched access rates to their comparable interstate switched access rate levels," further noting that "[w]ith the elimination of such subsidies, the Commission could then evaluate basic IUSF need in an environment without intrastate switched access cross subsidies." (Staff Ex. 2.0 at 21) This Staff recommendation "is intended to implement the statutory direction that implicit intrastate switched access charge subsidies be identified and rendered explicit." (Staff RB at 9)

If Staff's proposed methodology is adopted (as now endorsed by IITA and IBT), it will, consistent with the statutory directive in Section 13-301(2)(d), not only identify implicit interexchange access charge subsidies, but also render them explicit. Perhaps because it is "fatal to its position," CT&C fails to address the direct statutory guidance contained in Section 13-301(2)(d). Instead, CT&C argues that the Commission should not eliminate implicit subsidies resulting from switched access charges. CT&C bases this contention on policy positions supposedly informed by FCC action on federal universal service and intercarrier compensation reform, and General Assembly action

with respect to intercarrier compensation reform. According to Staff, "CT&C's arguments should be rejected because, while the actions taken by the FCC with respect to federal universal service and intercarrier compensation reform, and by the General Assembly with respect to intercarrier compensation reform may have some bearing on the Commission's policy determinations, they do not supersede the guidance regarding the Illinois universal service fund contained in Section 13-301(2)(d)." (Staff RB at 10)

While CT&C address changes that IITA made in response to the FCC's recent Intercarrier Compensation and Universal Service Order, CT&C does not recognize other changes made by IITA and AT&T to their intrastate access charge reduction proposal during the course of this proceeding. (*Id.)*

This, if it correctly characterizes the CT&C position, does not, in Staff's view, reflect concessions the IITA and AT&T have made. Specifically, IITA and AT&T adopted Staff's recommendation to amend their proposed funding mechanism from one that provided IUSF support constituting dollar-for-dollar replacement of access reductions, to one that takes implicit cross-subsidies from originating intrastate access revenues to basic local exchange services, and renders them explicit. In particular, under the mechanism initially proposed by IITA and AT&T, requesting companies were to receive IUSF support on a dollar-for-dollar basis for reductions in intrastate switched access charges. This support was to be provided regardless of whether such support was needed to provide basic local exchange services. (Staff RB at 11)

In response to Staff recommendations, IITA and AT&T now propose a fundamentally different methodology. Specifically, carriers will only seek recovery for lost access revenue if such reductions will reduce revenues that would otherwise cross-subsidize basic local exchanges services. For example, carriers that originally sought recovery for lost access revenues, but for whom such revenues were not used to cross-subsidize basic local exchange service, would no longer qualify for funding under the revised mechanism. In short, "rather than funding access charge reductions, the revised mechanism makes explicit originating intrastate switched access charge cross subsidies that were previously implicit, consistent with guidance in Section 13-301(2)(b)." (Staff RB at 11)

CT&C argues that as a consequence of FCC's *ICC/USF Order*, the IITA and AT&T eliminated their proposal for modifying intrastate terminating access fees and for recovering the revenue reduction from the IUSF and that this "eliminated nearly half of the total requested IUSF fee increases, or $7,580,423." (*Id*., citing CT&C IB at 5) According to Staff, "This is inaccurate; the amendments made in response to the FCC's Intercarrier Compensation and Universal Service Order do not explain the entire reduction cited by CT&C. This reduction was also, in part, the result of limiting funding of lost intrastate access revenue only to funding necessary to make implicit intrastate access charges subsidies explicit." (Staff RB at 11-12)

Regarding actions taken by the FCC with respect to federal universal service and intercarrier compensation reform, the CT&C argues that the current proposed funding

plan: "contravenes the FCC's transition plan and is inconsistent with the design and principles established in the FCC approach." (CT&C IB at 6) In fact, Staff argues, the FCC did no such thing. While the CT&C makes much of the FCC's determination to refrain from immediately imposing reductions in intrastate switched access charges, the FCC was clear that it "placed priority on reform of terminating access charges … mindful of the compromises that must be made to accomplish meaningful reform in a measured and timely manner." *ICC/USF Order*, ¶805. In doing so, the FCC stated, "[A]dopting a uniform federal transition and recovery mechanism will free states from potentially significant financial burdens[,] … [and] … will provide carriers with recovery for reductions to eligible interstate and intrastate revenue. As a result, states will not be required to bear the burden of establishing and funding state recovery mechanisms for intrastate access reductions, while states will continue to play a role in implementation. …[.]" *Id*., ¶795.

The FCC further stated, "To the extent that states have established rate reduction transitions for rate elements not reduced in this Order, nothing in this Order impacts such transitions. [citation] Nor does this Order prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed as a result of a faster transition." *Id*., ¶816. (Staff RB at 12)

While the FCC declined to compel states to bear such burdens and declined, at the time to do so through Federal subsidy mechanisms, it did not preempt states from making cross-subsidies contained in originating intrastate switched access charges explicit. (Staff RB at 13)

Similarly, while the CT&C note that Public Act 96-927 did not explicitly require incumbent local exchange carriers serving fewer than 35,000 lines to reduce intrastate access charges to interstate levels, nothing in Public Act 96-927 prevents the Commission from making cross-subsidies contained in originating intrastate switched access charges "explicit." Instead, in retaining the language of Section 13-301(2)(d), the General Assembly urged the Commission to create the Illinois universal service fund to make such implicit subsidies explicit. (*Id.)*

Staff concludes, "For all of the reasons above, the Commission should reject the CT&C recommendation to 'deny the proposal by the Illinois Independent Telecommunications Association and Illinois Bell Telephone Company to the extent that it requests an increase to the Illinois service fund to recover revenues resulting from a decrease in intrastate access rates.'" (Staff RB at 13)

3. AT&T Illinois' Reply

Section III.A of AT&T Illinois' reply brief is titled, "Originating Access Reforms Do Not 'Contravene' the FCC's Order, as the CTCA Claims; In Fact, the Order Expressly Authorizes Such Reforms."

The FCC found that the entire intercarrier compensation system, including originating access charges, is "unfair for consumers," "outdated," "riddled with inefficiencies and opportunities for wasteful arbitrage, and "eroding rapidly." *ICC/USF Order*, ¶ 790. With respect to originating access, the FCC found that "originating charges should ultimately be subject to the bill-and-keep framework" and that the legal framework of the FCC's order "is inconsistent with permanent retention of originating access charges." *Id.* ¶ 817. (AT&T Illinois RB at 10)

None of these determinations supports the CTCA's argument that the Stipulation "contravenes the FCC's transitional plan." The CTCA asserts that when the FCC ordered carriers to start phasing down terminating access rates, it prohibited the states from reducing originating access rates even if the carriers involved voluntarily agree to such reductions. According to AT&T Illinois, no prohibition against originating access reform appears in any one of the order's 1430 paragraphs or 2,582 footnotes. In fact, the FCC's *ICC/USF Order* expressly authorizes states to carry out such reforms. The FCC plainly stated that "[t]o the extent that states have established rate reduction transitions for rate elements not reduced in this Order, nothing in this Order impacts such transitions." *ICC/USF Order*, ¶ 816 n.1542. (AT&T Illinois RB at 11)

AT&T Illinois adds, "Even for those rate elements that are reduced by the FCC's order, like terminating access, that order merely 'sets a default framework, leaving carriers free to enter into negotiated agreements that allow for different terms.' *Id*. ¶ 739; see also *Id*. ¶ 812 ('[C]arriers remain free to enter into negotiated agreements that differ from the default rates established above')." (AT&T Illinois RB at 11)

By establishing federal recovery mechanisms for terminating access reform, the FCC has provided this Commission with an opportunity to implement the stipulated reforms on the originating side with much less burden on the IUSF. The maximum universal service support under the Stipulation, as revised, is $2.88 million; even if the IITA carriers make the requisite showing of need to justify that full amount, it is still only a quarter of the support called for by the original Stipulation. (*Id.* at 11-12)

The FCC's framework cited by CT&C only establishes a transition plan for terminating access elements, not the originating access elements addressed by the Stipulation here. With regard to originating access rates, the FCC's order only states the desired end result – that the rates ultimately go down to zero – and as shown above it invites the states (and the carriers themselves) to move towards that goal.

Further, CT&C is ignoring the reason why the FCC established a "uniform national framework" for terminating access in the first place. The FCC was not trying to prevent states from reducing access rates, as the CT&C suggests. Rather, the FCC stated that its intent was to prevent the states from delaying or stopping reform. In adopting a default transition for terminating access, the FCC explained "that, in some cases, state reform efforts have taken well over a decade, sometimes with little result" and that it sought to avoid further delay. *ICC/USF Order* ¶ 794 n.1477. (AT&T Illinois RB at 12)

The CT&C asserts that the FCC did not cap the originating access rates of rate-of-return carriers like the IITA members. AT&T Illinois responds, "But that does not mean that the FCC prohibited rate-of-return carriers from reducing their originating access rates if they voluntarily agree to do that and if the state commission approves." (*Id.* at 12-13)

In Section III.B of its reply brief, AT&T Illinois responds to contentions by CT&C that the Stipulation includes elements rejected by the FCC. CT&C characterizes the Stipulation as a "flash cut" and claims that the Stipulation is contrary to the FCC's "gradual transitional approach to access rate reform." (CT&C IB at 13) According to AT&T Illinois, the FCC adopted a gradual transition for terminating access because of circumstances that are not present here. The FCC's order was reducing interstate and intrastate terminating access rates all the way to zero for local carriers across the country; by contrast, the Stipulation here takes the modest step of reducing intrastate rates for a few small carriers in rural Illinois, to mirror the corresponding interstate rates. Further, the FCC's plan includes rate increases for the affected local carriers' customers, and the FCC naturally wanted to spread those increases over time. The Stipulation "does not include increases in local service rates that would fall solely on customers of small carriers; rather, if the participating IITA member demonstrates need, the support for that carrier would be spread out much more widely through the IUSF, so there is no need to spread reform over time." (AT&T Illinois RB at 14)

AT&T Illinois adds, "More fundamentally, while the FCC established a transition plan at a national level, the FCC's order specifically authorized states to consider state-specific circumstances and "reduc[e] rates on a faster transition provided that states provide any additional recovery support that may be needed. *ICC/USF Order*, ¶ 816 n.1542." (*Id.)*

AT&T Illinois believes CT&C is also wrong when it argues that the Stipulation is "founded on the basis that the reduction in intrastate originating access rates would be revenue neutral," and claims that the FCC "rejected" such recovery. The IITA revised the Stipulation to make clear that its participating carriers would not be guaranteed a dollar-for-dollar recovery of access reductions. Support under the Stipulation is not based on the carrier's reduction in access revenues, but on a showing of need. The reduction in access revenues simply sets the upper bound on support. (AT&T Illinois RB at 14-15)

At any rate, while the FCC decided not to provide dollar-for-dollar recovery for federally mandated reductions in terminating access, it did not prohibit the states from providing for full recovery of originating access reductions agreed to at the state level. In fact, when it turned to the subject of state support funds, the FCC said that its order does not "prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed." *ICC/USF Order*, ¶ 816 n.1542. (AT&T Illinois RB at 15)

In Section III.C of its reply brief, AT&T Illinois argues, "The Stipulation is fully consistent with the General Assembly's express mandate that the Commission reduce implicit subsidies." (*Id*. at 16) The Stipulation is consistent with Section 13-301 of the Public Utilities Act, which authorizes the Commission to establish new state universal service funds, and in so doing it directs the Commission to "[i]dentify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit." 220 ILCS 5/13-301(1)(d), (2)(b). The Stipulation here would refine the existing Illinois universal service fund to "make explicit" the implicit subsidies in the IITA's "interexchange access charges."

Section 5/13-900.2, relied upon by CT&C, requires carriers with more than 35,000 lines to reduce their intrastate switched access rates and mirror the corresponding interstate rates. According to AT&T Illinois, the statute does not force small carriers to reduce their intrastate rates, but by its plain terms it does not prohibit those carriers from reducing their intrastate rates voluntarily. (AT&T Illinois RB at 16-17) The statute that applies to small carriers is Section 13-301, which extends to "all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges," without exempting small carriers. In AT&T Illinois' view, Section 13-301 plainly authorizes the Commission to make those subsidies explicit through universal service report. (*Id.* at 17-18)

In Section III.D of its reply brief, AT&T Illinois disagrees with CT&C's position that the IITA/AT&T Illinois proposal is premature. According to AT&T Illinois, "The CTCA's fundamental error is in saying (at 17) that the FCC 'already has established an interim plan for originating access' and suggesting that the Stipulation somehow differs from that plan. The CTCA has ignored the most important piece of the FCC's 'interim plan' – namely, the FCC's express statement that states are free to implement 'rate reduction transitions for rate elements not reduced in this Order' (like originating access) to address local concerns while the FCC considers much deeper reforms nationwide. *ICC/USF Order*, ¶ 816 n.1542." (AT&T Illinois RB at 19-20)

G. Commission Analysis and Conclusion

As indicated above, Section 13-301(1)(d) provides, among other things, that the Commission shall, "if appropriate, establish a universal service support fund from which local exchange telecommunications carriers who pursuant to … [certain] orders of the Commission … received funding and whose economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services…."

In Docket No. 11-0211, the IITA initially sought approval of a Stipulation and Agreement between the IITA and AT&T Illinois. The Stipulation provided for an update of the IITA carriers' current Illinois USF high-cost support, using an updated forward-

looking HAI Cost model combined with a rate-of-return review identified as Form 1.01, also known as Schedule 1.01. This methodology had been used previously to establish the IUSF in Consolidated Docket Nos. 00-0233/0335.

Under the original Stipulation, the IUSF-funded companies would utilize the updated Form 1.01 to establish a need and their individual qualification for IUSF support. In calculating the increased amounts of support sought, the IITA utilized, as an input, an affordable rate of $20.39 per month, which was the affordable rate established in the 00-0233 Proceeding. (AT&T Illinois IB at 1-2)

The original Stipulation also included a provision whereby the participating IITA carriers would adjust their intrastate originating and terminating switched access rates to levels that would mirror their respective interstate switched access rates and structure. The HAI Cost Model was then used again to determine the legislatively-permitted proxy cost and to determine the amounts of subsidy in switched access rates. The original Stipulation identified a $10.4 million funding replacement mechanism for mirroring intrastate switched access rates and structure with the interstate rates and structure.

The original Stipulation was filed prior to the issuance by the FCC of its *ICC/USF Transformational Order* addressing universal service and intercarrier compensation reforms.

Following a review of the FCC's *Transformational Order*, the IITA, the IITA Member Intervenors, the Staff, AT&T Illinois, and the Frontier Companies presented a Consensus Position and an interim update based on their Consensus Position. The Consensus Position provides as follows:

> 1. No later than two years from issuance of this order, one or more eligible recipients of IUSF, or an organization representing them such as the IITA, shall petition the Commission for approval of a longer-term IUSF to replace the Interim Fund. Such petition, and any resulting longer-term IUSF, shall be based upon a different methodology, absent a showing that no such alternative methodology is reasonably feasible.
>
> 2. The Interim Fund should be based upon an updated "need showing" using the Schedule 1.01 methodology used by the Commission in establishing the original IUSF effective October 1, 2001. That analysis and showing will also incorporate the affect of all companies seeking and qualifying for the Interim Fund reducing originating intrastate switched access charges to "mirror" originating interstate switched access charges contemporaneous with the effective date of the Interim Fund.
>
> 3. Any "Longer Term" IUSF replacing the Interim IUSF resulting from this docket shall be: (a) compliant with the terms and requirements of Illinois Section 13-301 of the Illinois Public Utilities Act, (b) consistent with

and fully reflect the Commission's concerns and admonitions, as stated in its several Orders in Docket Nos. 00-0233/0335 and 04-0354, regarding continued use of a rate-of-return based methodology to determine IUSF support levels, and (c) consistent with FCC policies and rules applicable on an interstate level to Illinois ILECs potentially eligible for IUSF support pursuant to Section 13 301(1)(d) of the Illinois PUA.

4. The Interim Fund will terminate on the implementation of the longer term IUSF.

Those parties propose, "based on the substantial record evidence in this docket," that "an interim update to the IUSF based on the[ir] Consensus Position" be approved.

The original Stipulation had provided that the IITA members who signed on to the Stipulation and Agreement reduce both their intrastate originating and terminating switched access rates and rate structure to mirror their respective interstate levels. According to AT&T Illinois, the update to the IUSF based on to the Consensus Position reduced the $10.4 million funding replacement mechanism identified in the Stipulation and Agreement to a ceiling of $2.88 million. This reduction reflects the effects of the phase-down of terminating access rates pursuant to the *Transformational Order*. (AT&T IB at 6-7; RB at 17) As stated by IITA, terminating switched access is no longer a subject of this docket.

With respect to originating access charges, the Consensus Position adopts the recommendation of Staff witness Dr. Zolnierek as described above.

The Cable Television & Communications Association, also known as CT&C, takes issue with the "originating access proposal" in the Consensus Position. CT&C argues that the Consensus proposal "to increase the IUSF by $2,881,511 to offset a reduction in originating access rates should be rejected." According to CT&C, the Consensus proposal "ignores the FCC and the Illinois statutes determinations to balance (1) the transition of access charges, (2) the revenue needs of the rate-of-return ILECs, and (3) the burden on consumers in supporting universal service, by only addressing (1) the AT&T Illinois request for lower access rates and (2) the IITA's revenue requests, while ignoring (3) the burden on the consumer of the increase in universal service charges." (CT&C draft order at 2-3) CT&C also argues that "with further action being contemplated by the FCC on originating access charges, it would be rash for this Commission to take any further steps at this point in time to address the issue." (*Id.* at 5)

Based on the evidence of record, the Commission finds that there should be an interim update to the IUSF as proposed in the Consensus Position advanced by the IITA, the IITA Member Intervenors, the Staff, AT&T Illinois, and the Frontier Companies. Unlike the original Stipulation, the Consensus position incorporates Dr. Zolnierek's methodology with respect to the treatment of originating access charges in updating the IUSF. That is, the proposed funding mechanism in the Stipulation was replaced by one

that provided IUSF support constituting dollar-for-dollar replacement of access reductions, to one that takes implicit cross-subsidies from originating intrastate access revenues to basic local exchange services, and renders them explicit.

As a result, carriers will only seek recovery for lost access revenue if such reductions will reduce revenues that would otherwise cross-subsidize basic local exchanges services. For example, carriers that originally sought recovery for lost access revenues, but for whom such revenues were not used to cross-subsidize basic local exchange service, would no longer qualify for funding under the revised mechanism. In short, rather than funding access charge reductions, the revised mechanism "makes explicit" originating intrastate switched access charge cross-subsidies that were previously implicit, consistent with guidance in Section 13-301(2)(b). The impact of mirroring interstate originating switched access has been treated as a revenue reduction in the Schedule 1.01s "needs showing" supporting basic IUSF. (Joint draft order at 33)

As such, Dr. Zolnierek's methodology will, consistent with the statutory directive in Section 13-301(2)(d), not only identify implicit interexchange access charge subsidies, but also render them explicit. Section 13-301(2)(d) directs the Commission, when creating the universal service fund at issue here, to "Identify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund."

The Commission also agrees with the parties to the Consensus Position that the Staff methodology is not inconsistent with the FCC's transition plan. As noted by Staff, while the FCC "placed priority on reform of terminating access charges … mindful of the compromises that must be made to accomplish meaningful reform in a measured and timely manner," it did not "prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed as a result of a faster transition." *FCC Transformational Order*, ¶805, 816. The methodology for determining IUSF relief in the Consensus Position, as explained above, is not inconsistent with the FCC findings, and approval of it as part of the interim relief granted in this Order is not premature.

V. S CORPORATION ISSUE

In its testimony, Staff proposed an adjustment "to allow no amount for imputed income taxes in calculating the level of…IUSF funding" for five S Corporations. (Staff RB at 14) The S Corporations and the IITA oppose the Staff adjustment.

As indicated above, the descriptions and summaries of parties' positions on the issues, wherever they may be contained in this order, are not intended to reflect the opinions of or determinations by the Commission unless otherwise noted.

A. Staff Position

These five rural companies seek recognition of state and federal income taxes as an expense, and also use a gross revenue conversion factor ("GRCF") that included a provision for income taxes in their Schedule 1.01s. (Staff IB at 9, citing Staff Ex. 5.0 at 8)

However, each of the companies has elected to be treated as an S Corporation for federal, and thereby state, income tax purposes. (Staff Ex. 5.0(S) at 6) In Staff's view, this is significant, since the whole purpose of S Corporation treatment is set forth in the Internal Revenue Code, which provides that: "[e]xcept as otherwise provided in this subchapter, an S Corporation shall not be subject to the [federal corporate income] taxes imposed by this chapter." 26 U.S.C. §1363(a).

Instead, the obligation to pay federal income taxes is "passed through" to the shareholders under the terms of Section 1366 of the Internal Revenue Code, 26 U.S.C. §1366. In short, the companies in question do not pay corporate income taxes. (Staff IB at 10) Rather, they are taxed in a manner similar to the tax treatment afforded partnerships. (Staff RB at 14) Nonetheless, each has included imputed income taxes and also used a gross revenue conversion factor ("GCRF") that included a provision for income taxes in its Schedule 1.01 (as revised March 23, 2012), which results in more IUSF funding than would otherwise be received. (Staff IB at 9-10, citing Staff Exhibit 5.0(S) at 6-7)

The "central issue" is whether the Commission should allow in the determination of IUSF funding, an amount representing income taxes which the corporation simply does not pay. (Staff RB at 14) In Staff's view, the Commission "should reject the IITA's assertion that companies should be granted an allowance for an expense item for income taxes that they…do not pay, especially where, as here, it will result in an increase to each company's IUSF subsidy – in this case, a wholly unjustified and unearned one, since no expense is incurred. IUSF funding should not include income tax expense that the Companies do not incur." (Staff RB at 14-15)

The IITA argues in rebuttal that Staff's funding calculation is unfair, asserting that it will favor investment in companies organized as C corporations, which pay corporate taxes, and whose shareholders are then taxed on dividends and distributions. (IITA Ex. 3.0 at 34) However, IITA's arguments fail to consider that the companies organized as S Corporations are not subject to the double taxation that the other corporations are subject to. Most corporations pay income tax on income they earn and, if dividends are paid to their shareholders, the shareholders pay income taxes on those dividends. An S Corporation's income, however, is not taxed at the corporate level, only at the shareholder level. Thus, funding through IUSF should not include a subsidy for income tax expenses that the Companies simply do not incur. (Staff IB at 10-11; Ex. 5.0 at 8-9)

IITA and the S Corporations also argue that National Exchange Carriers Association ("NECA") allows an imputation in its cost study information in NECA access

pools and that the Federal Energy Regulatory Commission ("FERC") allows rate recovery of the income tax liability attributable to regulated utility income. (IITA Ex. 3.0 at 34-35)

According to Staff, "to argue that other agencies or regulatory bodies (one of which, the FERC, in any case regulates electric transmission rates) allow an imputation based on the shareholder's effective weighted income tax rate is not relevant to whether this is appropriate in this proceeding." The question in this proceeding is essentially what costs the rural companies incur to provide supported services, and how much federal support they receive to do so; the difference between such costs less federal support, and the Commission-established "affordable rate," determines the level of IUSF support. 220 ILCS 5/13-301(1)(d); (2)(c). Including cost not incurred would be contrary to the Illinois statute, which requires a showing of the funded companies' "economic costs of providing [supported] services[.]" 220 ILCS 5/13-301(1)(d). (Staff IB at 11)

Furthermore, IITA has not demonstrated that the Commission has allowed recovery of taxes that are not incurred or paid by the corporation. In contrast, Staff's recommendation is consistent with the prior practice of the Commission. In the case of *Monarch Gas Co. v. Commerce Comm'n*, 51 Ill. App.3d 892; 366 N.E.2d 945 (5th Dist. 1977) ("*Monarch Gas")*, the appeal arose from a Commission decision in Docket No. 59460, in which Monarch filed for an increase in its gas rates, including recovery of income tax expense. *Monarch Gas*, 51 Ill. App.3d at 893; 366 N.E.2d at 946. The Commission found that, in 1970, Monarch had elected, pursuant to Subchapter S of the Internal Revenue Code (26 U.S.C. § 1361, et seq.) to be taxed through its stockholders on the taxable income of the corporation, in lieu of paying the corporate tax. *Id*. Since Monarch itself paid no income tax, the Commission rejected the amount the corporation would have paid in computing operational expenses. *Id*., 366 N.E.2d at 947.

The Appellate Court affirmed the Commission's Order, stating, "Monarch contends that the purpose of Subchapter S would be frustrated if income taxes were not included in operating expenses. We do not agree. … Monarch fails to cite, and our research does not disclose any intent on the part of Congress to require the inclusion of income taxes that would have been paid in the operating cost of a public utility subject to state regulation." *Monarch Gas* at 895-896; 366 N.E.2d at 948.

In so ruling, the Appellate Court found persuasive the rationale used in two other cases, *Federal Power Comm'n. v. United Gas Pipe Line Co.*, 386 U.S 237; 18 L. Ed. 2d 18; 89 S. Ct. 1003 (1967) and *City of Alton v. Commerce Comm'n*, 19 Ill. 2d 76; 165 N.E.2d 513 (1960), stating that: "Subchapter S permits a corporation to elect to 'pass through' its income and thereby avoid a double tax on the income. It does not purport to control the determination of operating expenses and rates of public utilities." *Monarch Gas* at 897; 366 N.E.2d at 949. (Staff IB at 11-12; RB at 15)

In addition, Staff argues, the FERC decision appears on its face to apply specifically to ratemaking, as opposed to establishing a subsidy amount; and "the tax transactions it appears to deal with are complex and multi-tiered, as opposed to the

ones at issue here (which presumably involving distributions to individual owners/employees)." (Staff RB at 16)

The S-Corps also contend that Staff's position leads to a discriminatory outcome. According to Staff, this assertion is without merit. Each of the S Corporations made a voluntary election based on NECA and now is unhappy with the result of their individual elections. Each S Corporation will receive funding for expenses actually incurred. What none of the S Corporations will receive is funding in excess of actual income taxes incurred. (Staff IB at 15; RB at 16)

The S-Corps argue that the customers of an S corporation will benefit from the company's election to be an S corporation rather than a C corporation since the composite tax rate of the shareholder is generally lower than that of a C corporation. According to Staff, while this is true, it is not relevant. The option by the S-Corps to impute a lower income tax rate is still based on an income tax expense that is not incurred by the corporation and thus, does not require funding to recover. In their testimony, the S-Corps argue that: "[a]dopting Ms. Everson's approach will likely cause one of more of the affected companies to revoke its S corporation election and revert to a C corporation …but ultimately imposing higher rates on customers to offset the higher tax costs." (S-Corps IB at 7) Staff claims this argument is without merit, since Staff's proposed funding through the IUSF makes these companies whole for the expenses they actually incur. (Staff RB at 17)

With regard to Accumulated Deferred Income Tax, the companies also requested accumulated deferred income tax as an inclusion in their Schedule 1.01s. The amounts shown on Schedule 1.01 for the companies for deferred income taxes are amounts are imputed based on the Companies' assumption that they will be able to recover those imputed amounts.

In Staff's view, "the Commission should reject the IITA's assertion that companies should be granted an allowance for an expense item for income taxes that they concede they do not pay, especially where, as here, it will result in an increase to each company's IUSF subsidy – in this case, a wholly unjustified and unearned one, since no expense is incurred. IUSF funding should not include income tax expense that the Companies do not incur." (*Id*. at 18) Further, regarding accumulated deferred income tax, if a Company does not pay an expense, it cannot have an accumulation of that expense.

B. Position of IITA and S Corporations

The Five S Corporation Intervenors contend that the federal and state income taxes paid by the S corporations shareholders as the result of income earned by their respective telephone companies should be treated as an expense to the telephone companies for purposes of the IUSF just as the federal and state income taxes incurred by C corporations as the result of the income they earn is an expense to the C corporations. These S Corporation Intervenors have included the weighted average tax

liability of their shareholders on their Schedule 1.01a. (S-Corps IB at 2; IITA Exhibit 3.0 at lines 784-787)

In the IITA's initial filings in this docket, consistent with the IITA's Stipulation and Agreement with AT&T Illinois, each of the IITA Member Intervenors, including these five companies, imputed a uniform tax liability of 34% for its federal income taxes and 7.3% for state income taxes, reflecting the expedited process agreed between the IITA and AT&T Illinois. (IITA IB at 20)

After Staff and the Geneseo Companies raised issues about the uniform tax treatment used by all the IITA Member Intervenors, a number of the IITA Member Intervenors adjusted their estimated tax liability. Specifically, any C corporation whose income was insufficient to reach the 34% tax bracket reduced the Schedule 1.01 entry to its actual tax expense. The five S corporations substituted the weighted average tax liability of their shareholders. (IITA IB at 20-21; S-Corps IB at 4)

Under the IITA proposal, federal and state income taxes related to the income earned by each of the S corporations would be recognized as a legitimate business expense related to the income earned even though the tax bill is paid by the shareholders. There would be no recognition in the process of any dividends any S corporation actually pays to its shareholders. The IITA contends that income tax cost caused by the corporation, whether a C corporation or an S corporation, on corporate income is an unavoidable tax consequence of operating the company. By comparison, taxes paid by shareholders for dividends paid from a C corporation is a second-tier tax incurred not for corporate income, but for income to the shareholder incurred only if dividends are paid. The payment of dividends is done at the discretion of the corporate entity. (IITA IB at 21; S-Corps IB at 5-6)

Staff does not agree. Staff witness Ms. Everson contends that S corporations should get no credit for the tax liability of their shareholders because the liability does not attach to the S corporation itself. Ms. Everson has proposed adjustments to the Schedule 1.01s of the five impacted companies regarding both their federal and state tax liabilities. Through Staff Exhibit 5.0, Ms. Everson initially identified several different adjustments relating to her proposed treatment of S corporations. Based on her Supplemental Rebuttal Testimony, however, Ms. Everson reached agreement with the IITA on how the exclusion of S corporation tax liability would be accounted for in the Schedule 1.01s (although the IITA continues to oppose that exclusion). Consequently, the funding for each of the five S corporations reflected on Staff Exhibit 5.02S matches the funding listed on IITA Exhibit 5.11, which reflects the provisional funding sought by the IITA and its IITA Member Intervenors in case the Commission accepts Ms. Everson's position related to S corporations. (IITA IB at 21-22; S-Corps IB at 6)

The IITA and S Corporations oppose the exclusion of the cost of income taxes for S corporations for several policy based reasons. For example, Ms. Everson tries to justify her exclusion of the tax costs on S corporations by asserting that the IITA is ignoring "double taxation." (Staff Exhibit 5.0 at lines 169-172) She argues for different

treatment because shareholders of a C corporation, unlike shareholders of and S corporation, are subject to double taxation on any income the shareholder derives from the C corporation's operations. Specifically, Ms. Everson contends that a shareholder in a C corporation is impacted by the tax a C corporation pays on any income it earns, and that the shareholder pays a second tax (thus, "double taxation") on any dividend the shareholder receives from the corporation. By contrast, a shareholder in an S corporation pays tax only once on the income of the corporation. (IITA IB at 22; S-Corps IB at 6-7)

In fact, Ms. Everson's proposed treatment of the S corporations leads to a discriminatory income tax treatment based on the income tax elections made by the individual companies. While the value of a C corporation is impacted by its tax liabilities, that tax payment has no immediate impact on the C corporation's shareholders. Shareholders of a C corporation pay income tax only on the dividends paid by the corporation whose shares they own. If a C corporation pays no dividends, its shareholders have no income tax to pay. By contrast, shareholders of an S corporation pay their full share of the annual taxes on the corporation's income, regardless of whether a cash distribution is made to them. Depending on the distribution policy of the company, the shareholders of an S corporation may receive sufficient distributions from the corporation to pay the taxes or they may have to pay taxes out of other resources. (IITA IB at 22-23; S-Corps IB at 7)

According to IITA and the S Corporations, double taxation is not an issue. By comparison, in the ratemaking process for a C corporation, the federal and state income taxes that are paid are recognized in that process. Dividends, whether the company pays them or not, are not given any consideration in the ratemaking process. Neither does the ratemaking process take into consideration the tax rates that may be imposed on the shareholders of a C corporation who receive dividends. (IITA IB at 23; S-Corps IB at 7)

Moreover, the customers of an S corporation would generally benefit from the company being an S corporation rather than a C corporation because in most cases the composite tax rates of the shareholders are less than the corporate tax rates of the C corporation. Even though the income taxes paid by the shareholders of the S corporation are imputed in this instance "in the ratemaking process," the shareholders are usually better off than they would be if the company were organized as a C corporation because they pay the tax only on the overall earnings of the company and do not have any additional taxes to pay related to distributions or dividends. Equally important, the customers of an S corporation are better off because the taxes included in their rates are generally lower than they would be with a C corporation and because the shareholders are given additional financial incentives to invest in the company and the assets needed so the company can provide good service. (IITA IB at 23; S-Corps IB at 7-8)

Unfortunately, the other advantages of being an S corporation will be substantially offset by the regulatory treatment Staff advocates. Adopting Staff's

approach may cause one or more of the affected companies to revoke its S corporation election and revert to a C corporation, thus allowing them to count their tax liability for IUSF purposes, but ultimately imposing higher rates on customers to offset the higher tax costs. (IITA IB at 24; S-Corps IB at 8)

In evaluating the treatment of S corporations, the impacts of this policy choice have been carefully evaluated in a closely analogous circumstance by the Federal Energy Regulatory Commission ("FERC"). IITA Exhibit 5.08, the "FERC Order," is a complete policy determination by FERC on income tax allowances adopted in early 2005. (*Id*.)

The FERC Order is the result of an investigation FERC opened in response to U.S. Court of Appeals for the District of Columbia remanding one of FERC's orders. In the order under remand, FERC had applied a previously adopted approach called the "*Lakehead* policy." The Court remanded FERC's order because the Court found it was not supported by FERC's arguments propounded in that case. In response to the remand, FERC overturned the *Lakehead* policy. Basically, the *Lakehead* policy gave an income tax allowance to a partnership that owned a portion of the public utility if the partnership was owned by a corporation, but not if the partnership was owned by an individual or non corporate entity. The *Lakehead* policy is analogous to Staff's approach and has an identical impact on S corporations. A tax allowance is allowed for a corporation that pays the tax liability, but not, under Ms Everson's proposal, for a corporation that passes the tax liability through to its owners. (IITA IB at 24-25; S-Corps IB at 9)

In overturning the *Lakehead* policy FERC specifically recognized (at ¶ 33), "*Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service and therefore properly included in a regulated cost of service."

Ms. Everson is similarly focused on who pays the taxes in an S corporation rather than on the regulated services to which those taxes are attributable.

The FERC decision also addressed (at ¶ 33) the issue of whether the pass-through entity pays the taxes itself or not, and of whether such costs should be reimbursed as public utility costs.

> [S]ome commenters assert that because a pass-through entity pays no cash taxes itself, this results in a phantom tax on fictional public utility income. However, the comments summarized in sections A and D of Part II of this policy statement demonstrate that this assumption was incorrect. While the pass-through entity does not itself pay income taxes, the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity. Therefore, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of that entity as if the

> utility assets were owned by a corporation. The numerical examples discussed in sections A and D of Part II of this policy statement also establish that the return to the owners of pass-through entities will be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their public utility income.

IITA and the S Corporations assert, "Clearly, after reviewing the numerous comments it received from a number of very large and sophisticated corporations impacted by these issues, FERC found that it was appropriate (and the best policy alternative) to provide an income tax allowance for pass-through entities (such as partnerships and S corporations) on the public utility income that was passed through to them." (IITA IB at 25; S-Corps IB at 10)

FERC also considered (Order at ¶¶ 2 and 3) the double taxation issue because it was one of the rationales originally proposed by FERC in defending the *Lakehead* policy and one that the Appeals Court specifically found unconvincing. In its Order, FERC recognized (Order at ¶ 38) the flaw in its initial rationale as follows:

> In retrospect, it was the Commission's failure to distinguish between first and second tier income that lead to the double taxation rationale that the Commission incorrectly advanced in *Lakehead*. Dividends paid to the common stock investor and by the corporate investor in a pass-through entity are second tier income to such a common stock investor. As such, an income tax is paid by the investor in addition to the corporate tax that is due on the first tier income. In contrast, first tier income flows either to the corporation, a corporate partner, or individual partners (or LLC members) and is taxed at that level. To the extent *Lakehead* either concluded or assumed that dividend payments and income, and partnership distributions and income, have the same ownership and income tax characteristics, this is simply incorrect as a matter of partnership and income tax law.

The federal Court of Appeals for the District of Columbia reviewed this FERC policy decision, and upheld the new FERC order and the rationale adopted in the policy statement. *ExxonMobile Oil Corp. v. Federal Energy Regulatory Commission*, 487 F.3d 945. (D.C. Cir. 2007). (IITA IB at 26; S-Corps IB at 10)

Like FERC, the FCC, through the USF procedures promulgated by the National Exchange Carrier Association ("NECA"), allows S corporations to reflect the income tax liability of their shareholders for their federal USF calculations. See Leaf River Exhibit 3.0 at lines 31-40 (the NECA federal USF calculator tool produces the effective state and federal income tax rates of its shareholder group for S corporations); Grafton Exhibit 3.0 at lines 36-45 (Grafton became an S corporation only after the FCC and NECA allowed S corporation income taxes to be recovered by the operating telephone company). (IITA IB at 26)

The disallowance of the tax expense in IUSF support, as suggested by Ms. Everson, undermines the reliance the S Corporation Intervenors placed on the treatment of taxes by NECA in making the S election and would lead to inconsistent federal and state treatment contrary to the legislative intent. In *Harrisonville Tel. Co. v. Ill. Com. Com.*, 212 Ill.2d 237 250-252 (2004), the Commission refused to support any more than one access line per residence or business. On appeal, the Illinois Supreme Court determined that the legislative intent was to provide the same supporting mechanisms in the state universal service fund as the FCC does in the federal fund. In this case, NECA provides support to S corporations by including an average weighted income tax expense of the shareholders of S Corporations for federal universal service support. This Commission should follow the FCC's policy determination for tax treatment of S corporations as the Illinois Supreme Court mandated for second lines in Harrisonville. (IITA IB at 26-27)

On December 18, 2012, Leaf River, which is one of the S Corporations referenced above, filed a "motion to reopen." This issue is discussed below.

C. Commission Analysis and Conclusion

In its testimony, Staff proposed an adjustment "to allow no amount for imputed income taxes in calculating the level of…IUSF funding" for five S-Corporations. (Staff RB at 14)

These five rural companies sought recognition of state and federal income taxes as an expense, and also use a gross revenue conversion factor that included a provision for income taxes in their Schedule 1.01s.

Each of the companies elected to be treated as an S corporation for federal, and therefore state, income tax purposes. The Internal Revenue Code provides, "Except as otherwise provided in this subchapter, an S-corporation shall not be subject to the [federal corporate income] taxes imposed by this chapter." 26 U.S.C. §1363(a).

Instead, the obligation to pay federal income taxes is "passed through" to the shareholders under the terms of Section 1366 of the Internal Revenue Code, 26 U.S.C. §1366. In short, the companies in question do not pay corporate income taxes. (Staff IB at 10) Rather, they are taxed in a manner similar to the tax treatment afforded partnerships. (Staff RB at 14)

In this proceeding, each S corporation has included imputed income taxes and also used a GCRF that included a provision for income taxes in its Schedule 1.01 (as revised March 23, 2012), which results in more IUSF funding than would otherwise be received.

According to Staff, the "central issue" is whether the Commission should allow in the determination of IUSF funding, an amount representing income taxes which the

corporation simply does not pay. In Staff's view, IUSF funding should not include income tax expense that the Companies do not incur. (*Id*. at 14-15)

The S-Corporation Intervenors contend that the federal and state income taxes paid by the S corporations' shareholders as the result of income earned by their respective telephone companies should be treated as an expense to the telephone companies for purposes of the IUSF just as the federal and state income taxes incurred by C corporations as the result of the income they earn is an expense to the C corporations. The S Corporation Intervenors have included the weighted average tax liability of their shareholders on their Schedule 1.01a.

Having reviewed the positions of the parties, the Commission finds that the Staff adjustment "to allow no amount for imputed income taxes in calculating the level of…IUSF funding" for the S Corporations is appropriate and should be adopted.

The Commission agrees with Staff that these companies should not be granted an allowance for an expense item for income taxes that they do not pay, especially where, as here, it will result in an increase to each company's IUSF subsidy.

As Staff further observes, the IITA's arguments fail to sufficiently consider that most corporations pay income tax on income they earn and, if dividends are paid to their shareholders, the shareholders pay income taxes on those dividends; whereas, companies organized as S corporations are not subject to such double taxation.

The Staff adjustment is also consistent with the *Monarch Gas* decision cited by Staff. There the Commission found that Monarch had elected, pursuant to Subchapter S of the Internal Revenue Code, to be taxed through its stockholders on the taxable income of the corporation, in lieu of paying the corporate tax. Since Monarch itself paid no income tax, the Commission rejected the amount the corporation would have paid in computing operational expenses. The Commission's Order was affirmed by the Appellate Court.

The Commission also notes that on December 18, 2012, Leaf River, which is one of the S Corporations referenced above, filed a "motion to reopen." Leaf River states that it has made a corporate decision to revert back to a Chapter C corporation for tax purposes. By virtue of that decision, Leaf River seeks admission of exhibits on reopening "without hearing" which, according to AT&T Illinois, would increase Leaf River's annual IUSF funding request to $411,801.

On or before January 2, 2013, AT&T Illinois and Staff filed responses objecting to Leaf River's motion. Leaf River filed a reply on January 15, 2012.

Among other things, AT&T Illinois and Staff contend that the motion is not timely. They also argue that Leaf River's proposal would be "asymmetrical," in that it uses 2009 financial data while at the same time recognizing a 2012 tax election effective in 2013,

without updating other elements of Schedule 1.01, and that such a mismatch would be contrary to prior Commission Orders such as *Alhambra-Grantfork*.

Staff also comments that since the case has already been marked "Heard and Taken," Leaf River is apparently seeking relief under Section 200.870 of the Commission Rules of Practice, entitled "Additional Hearings," which allows a party to request "additional hearings" to offer "additional evidence." Here, however, Leaf River seeks to place the additional evidence into the record, over the objections of other Parties, "without hearing."

Having reviewed the filings, the Commission agrees with AT&T Illinois and Staff that Leaf River's motion seeking admission of the exhibits without hearing should not be granted. What Leaf River is proposing through these exhibits would increase its IUSF funding. Staff and AT&T Illinois have raised substantive concerns regarding a possible mismatch of financial data used to determine Leaf River's IUSF support. Under the circumstances, allowing Leaf River to simply insert those exhibits into the evidentiary record at this time without hearing, over the objections of other Parties, would not be appropriate.

VI. GCHC PROPOSAL TO ADD ACCESS TO BROADBAND AS A SUPPORTED TELECOMMUNICATION SERVICE

As indicated above, Section 13-301(1)(d) of the PUA provides, among other things, that the Commission shall, "if appropriate, establish a universal service support fund from which local exchange telecommunications carriers who pursuant to … [certain] orders of the Commission … received funding and whose economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services…."

Section 13-301(2)(a) provides, in part, that "In any order creating a fund pursuant to paragraph (d) of subsection (1), the Commission … shall [d]efine the group of services to be declared 'supported telecommunications services' that constitute 'universal service.'" There are currently nine such supported services.

In this proceeding, Geneseo, Cambridge and Henry Telephone Companies, referred to as GCHC or Geneseo, propose to add Access to Broadband Services as a supported telecommunications service eligible for IUSF funding. They also propose an alternative method of determining their IUSF funding. Staff, AT&T Illinois, the IITA and the IITA Member Intervenors oppose the GCHC proposal.

A. GCHC Position

1. Basis for GCHC Proposal

In GCHC's estimation, given the nature of services currently offered to and demanded by customers from telecommunications carriers today, well-established Illinois and national policies, and the recent actions and declarations of FCC, universal service should include Access to Broadband Services. (GCHC draft order at 9)

GCHC contends this result is not only sound as a matter of public policy, but, in addition to voice service, a fundamental policy goal on both the national and state levels. At the national level, Congress expressed this policy in the American Recovery and Reinvestment Act of 2009 where it stated its desire "to ensure that all people of the United States have access to broadband capability." The FCC acted to further this policy goal by entering a landmark *ICC/USF Transformational Order* in which the FCC overhauled the federal Universal Service Fund not only to allow federal universal service funds to be used to support broadband services, but to require that the federal high-cost fund be transformed to make support for broadband services the focus of federal USF funding. (GCHC Ex. 3.0 at 3-6)

The FCC summarized the importance of Access to Broadband Services underlying this decision as follows:

> Networks that provide only voice service . . . are no longer adequate for the country's communications needs. Fixed and mobile broadband have become crucial to our nation's economic growth, global competitiveness, and civic life. Businesses need broadband to attract customers and employees, job-seekers need broadband to find jobs and training, and children need broadband to get a world-class education. Broadband also helps lower the costs and improve the quality of health care, enables people with disabilities and Americans of all income levels to participate more fully in society. Community anchor institutions, including schools and libraries, cannot achieve their critical purposes without access to robust broadband. Broadband-enable jobs are critical to our nation's economic recovery and long-term economic health, particularly in small towns, rural and insular areas and Tribal lands. (GCHC draft order at 9-10, citing GCHC Ex. 3.2 at ¶¶ 3-4)

The State of Illinois similarly has emphasized the importance of supporting and expanding Access to Broadband Services for its citizens. In Section 13-804 of the Act, the Illinois legislature stated, "Increased investment into broadband infrastructure is critical to the economic development of this State and a key component to the retention of existing jobs and the creation of new jobs." (GCHC draft order at 10)

It is upon this backdrop that GCHC requests that the Commission review and revise the existing group of "supported telecommunications services" that constitute

"universal service" under Section 13-301 of the Act to add "Access to Broadband Services." Section 13-301 requires the Commission to investigate the necessity of and, if appropriate, establish a universal support fund. 220 ILCS 5/13-301(1)(d). This the Commission has done, establishing the IUSF over 10 years ago in the Prior Consolidated Dockets. But, GCHC contends, the requirements of Section 13-301 and the Commission's obligations do not stop there. Section 13-301(2)(a) provides that once the IUSF was created, the Commission became obligated "from time to time or upon request," to "review and, if appropriate, revise the group of Illinois supported telecommunications services and the terms of the fund to reflect changes or enhancements in telecommunications needs, technologies, and available services." (*Id.*)

It is GCHC's position that the time has come for the Commission to revise the group of "supported telecommunications services" as envisioned in Section 13-301(2)(a) by adding "Access to Broadband Services."

GCHC defines "Access to Broadband Services" as "plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services." (GCHC Ex. 3.0 at 10; Ex. 4.0 at 4; Ex. 5.0 at 8; IB at 6-10) GCHC bases this definition on the FCC's amended 47 C.F.R. § 54.7, which governs the use of federal USF support, to provide:

> (a) A carrier that receives federal universal support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.
>
> (b) The use of federal universal support that is authorized by paragraph (a) shall include investments in plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services.
> (GCHC Ex. 3.2. at 539)

By adopting and tracking the language used by the FCC in its own rule, this definition will benefit from the ability of the Commission and Illinois carriers eligible for IUSF funding to rely upon how the FCC applies and interprets 47 C.F.R. § 54.7(b). Thus, GCHC states that "Access to Broadband Services" shall mean all plant and facilities that by themselves or in connection with other plant and/or facilities, provide access to "broadband service" as defined by the FCC in the *ICC/USF Transformational Order* for rate-of return carriers – i.e., broadband service at speeds of at least 4 Mbps downstream and 1 Mbps upstream with latency suitable for real-time applications, such as VoIP, upon reasonable request. (GCHC draft order at 11)

GCHC's proposed definition for Access to Broadband Services as a supported telecommunications service in terms of plant or facilities is consistent with the PUA's definition of "telecommunications service" in Section 13-203, which includes "all instrumentalities, facilities, apparatus, and services" used to provide the "transmittal of information" by electromagnetic means. 220 ILCS 5/13-203. GCHC also relies upon the

Supreme Court of Illinois' decision in *Illinois-Indiana Cable Telephone Association v. Illinois Commerce Comm'n*, 55 Ill. 2d 205, 219 (1973), in which the Court distinguished the term "telecommunications service" as being broader than the term "telephone service." (GCHC draft order at 11)

Turning to the basis for its proposal to add Access to Broadband Services as the 10th supported telecommunications service in Illinois, GCHC argues that there are two reasons the Commission should do so under Section 13-301(2)(a) of the PUA. The first is that the addition of Access to Broadband Services is required by the language of Section 13-301(a)(2) that provides "at a minimum," the group of supported telecommunications services that constitute universal service "shall . . . include those services defined by the [FCC] and as from time to time amended" based on the FCC's actions in the *ICC/USF Transformational Order*.

GCHC acknowledges that the FCC did not include the terms "broadband" or "broadband service" in the amended language of its rule listing "services designated for support" in 47 C.F.R. 54.101(a), but points our that the language of the PUA's Section 13-301(2) (a) does not directly refer to or limit the phrase "those services defined by the [FCC] and as from time to time amended" to 47 C.F.R. 54.101(a). GCHC argues that the Supreme Court of Illinois' decision in *Harrisonville Telephone Company v. Illinois Commerce Commission* supports this conclusion and held that Section 13-301(2)(a) requires that minimum "universal service" in Illinois encompass more than the mere "words" of 47 C.F.R. § 54.101(a). (GCHC draft order at 11)

In *Harrisonville Telephone Company*, the Supreme Court of Illinois reviewed the Commission's determination in the Second Interim IUSF Order and Order on Rehearing to adopt the nine services as stated by the FCC in 47 C.F.R. § 54.101(a) (1998) but limit support to a single residential or business line. 212 Ill. 2d at 239-241. The Commission had acknowledged that the FCC determined support based on all access lines, but found that Section 13-301 simply indicated that the Illinois list of supported services should be no smaller than the federal list and did not require the Commission to "walk in lock step with the FCC" on the inclusion of all access lines to determine the amount of support. *Id*. at 241. The Supreme Court of Illinois rejected the Commission's position. In doing so, the Court went beyond the mere language of 47 C.F.R. § 54.101(a) (1998) and examined the FCC's order establishing federal USF to determine that the FCC deemed "universal service" to include support for all access lines. The Court concluded that the Commission must do the same in establishing what minimum "universal service" is for Illinois under Section 13-301. *Id*. at 249-252. The Court stated that "[u]niversal service means universal service," reasoning that it would be "incongruous to suggest that the legislature wanted the [Commission] to follow the FCC's words but not its deeds . . . ." *Id.* at 251.

Based on the *Harrisonville Telephone Company* decision, GCHC argues that what the FCC did in the *ICC/USF Transformational Order* was to make universal service mean access to both broadband and voice services. GCHC reasons that by requiring that rate-of-return carriers now use their federal USF support to achieve "universal

availability of voice and broadband" while simultaneously amending 47 C.F.R. § 54.7(b) to allow federal USF support to be used on "plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services," the FCC has made Access to Broadband Services a necessary component of "universal service." GCHC further relies on the following statements and actions by the FCC in the *ICC/USF Transformational Order* for its position that the FCC made access to broadband services a component of universal service:

> Declares that the purpose of the *FCC/USF Order* is to "comprehensively reform[] and modernize[] the universal service and intercarrier compensation systems to ensure that robust, affordable voice and broadband service . . . are available to Americans throughout the nation." (GCHC Ex. 3.2 at ¶ 1)
>
> States that "The universal service challenge of our time is to ensure that all Americans are served by networks that support high-speed broadband access – in addition to basic voice service – where they live, work, and travel" (*Id*. at ¶ 5)
>
> Adopts "support for broadband-capable networks as an express universal service principle" (*Id.* at ¶ 17)
>
> Adopts "support for advanced services" as a universal service principle, whereby universal service support "should be directed where possible to networks that provide advanced services, as well as voice services" (*Id*. at ¶ 45)
>
> Establishes that one of the goals of universal service funding is to "ensure universal availability of modern networks capable of providing voice and broadband service to homes, businesses, and community anchor institutions." (*Id.* at ¶ 17; see also *id*. at ¶¶ 48, 51)
>
> Creates the Connect America Fund ("CAF") to "ultimately replace all existing high-cost support mechanisms," in order to "help make broadband available to homes, businesses, and community anchor institutions in areas that do not, or would not otherwise, have broadband." (*Id.* at ¶ 20) The CAF is to be "broadband-focused." (*Id*. at ¶ 1031)

GCHC's position is that based on *Harrisonville Telephone Company* and the language of Section 13-301(2)(a), these "deeds" by the FCC in the *ICC/USF Transformational Order* require that the Commission add Access to Broadband Services in the group of supported telecommunications services that constitute "universal service." (GCHC draft order at 13)

The second reason why Access to Broadband Services should be made a supported telecommunications service is that even if the Commission concludes that the FCC's *ICC/USF Transformational Order* does not make Access to Broadband Services one of the "services defined by the [FCC] and as from time to time amended" that must be included as part of Illinois universal service, Section 13-301(2)(a) makes it clear that the FCC's list of services is only to be the "minimum." The language of Section 13-301(2)(a) provides that in addition to the FCC list of supported services, in determining the group of supported telecommunications services that constitute universal service, the Commission must consider "the range of services currently offered by telecommunications carriers offering local exchange telecommunications service, the existing rate structures for the supported telecommunications services, and the telecommunications needs of Illinois consumers." Further, Section 13-301(2)(a) directs that when reviewing the group of Illinois supported telecommunications services the Commission, if appropriate, is to revise the group "to reflect changes or enhancements in telecommunications needs, technologies, and available services." (*Id.)*

Based on this language of Section 13-301(2)(a), the record demonstrates that available technology and services, the needs of Illinois telecommunications customers and their demands require that the Commission add Access to Broadband Services as a supported telecommunications service in Illinois. While the group of Illinois supported telecommunications services adopted by the Commission in the *Second Interim IUSF Order* has not been amended or changed in the over 10 years since being established, technology, the available services available to be offered by LECs, and the needs of Illinois telecommunications customers have changed dramatically in that time. (GCHC Ex. 1.0 at 5; Ex. 3.0 at 7; GCHC draft order at 13-14)

An example of the "dramatic changes" that have occurred is that when Section 13-517 of the PUA was enacted in 2001, it defined "advanced telecommunications services" as services capable of supporting, in at least one direction, a speed in excess of 200 kilobits per second. 220 ILCS 5/13-517(c) (2001). By contrast, the minimum broadband speed that rate-of return carriers are now required by the FCC to provide, upon reasonable request, is 20 times that rate – 4 Mbps downstream and 1 Mbps upstream. (GCHC Ex. 3.0 at 11-12) GCHC states that this is the level of broadband service that the FCC has found to "have become crucial to our nation's economic growth, global competitiveness, and civic life" for business, job growth, education and health care. (GCHC Ex. 3.2 at ¶ 3)

As stated by the FCC, the "common applications" needed by today's telecommunications customers include "distance learning, remote health monitoring, VoIP, two way high quality video conferencing, Web Browsing, and email," and "[n]etworks that provide only voice service . . . are no longer adequate for the country's communication needs." (GCHC draft order at 14) In GCHC's view, access to Broadband Services is required for customers to meet these needs.

GCHC concludes that it is appropriate for the Commission to revise the group of Illinois supported telecommunications services pursuant to Section 13-301(2)(a) to include Access to Broadband Services. (*Id.)*

2. Affordable Rate; Alternative Way to Determine IUSF Funding

In connection with adding Access to Broadband Services as a supported telecommunications service eligible for IUSF funding, GCHC submitted an analysis to support establishing an "affordable rate" of $15.46 per line per month for Access to Broadband Services as required by Section 13-301(1)(d) and (2)(c) of the Act. GCHC believes that it would not be appropriate to apply the $20.39 affordable rate established 10 years ago for the other nine supported service to a new and different supported telecommunications service that was not considered as part of the analysis underlying that amount. GCHC thus presented testimony supporting a from the "ground up" analysis to establish an affordable rate for Access to Broadband Services based on the premise that the purposes of this figure is to (a) represent an amount all customers in Illinois could "afford," including low income customers, and (b) be an amount that would promote the concept of this service being "universal" – i.e., that virtually all customers would be willing to pay the rate to purchase the service. (GCHC draft order at 15; Ex. 3.0 at 17)

GCHC starts with a FCC February 2010 survey finding that 35% of Americans did not have broadband service. Of the persons surveyed, 36% stated that cost was the reason they did not have access to broadband services. Using available figures for 2008 showing that the federal poverty income level for a family of four is $21,200, GCHC calculates that this equals 37.7% of the $56,230 median Illinois household income in 2008. Turning to the average cost facing consumers, according to the FCC's survey, the average monthly cost for access to broadband services is approximately $41.00. GCHC reasons that to equalize the impact of the cost for Access to Broadband Services on an average family at the poverty level to that of a household with a median level of income, the ratio of poverty income level to median Illinois household income level (37.7%) was multiplied against the average monthly cost for access to broadband services ($41.00), resulting in $15.46. To meet the goal of promoting universal adoption, GCHC checked this amount against findings in the FCC survey showing that virtually all non-adopters of broadband would be willing to pay a rate in the range of $10 to $20 per month for broadband, and found its calculated rate to be in the center of that range. Based on this analysis, GCHC proposes that the Commission establish an affordable rate for Access to Broadband Services in the amount of $15.46. (GCHC draft order at 15; IB at 20-22)

GCHC proposed an "alternative way" a carrier could elect to determine the amount of its IUSF funding. GCHC's proposal begins with the position that the "economic costs" used in connection with Access to Broadband Services should be the "actual costs" a carrier spends on Access to Broadband Services – i.e., on "plant that can, either as built or with the addition of plant elements, when available, provide

access to advanced telecommunications and information services." (GCHC draft order at 15)

Although the Commission concluded that "economic costs" for the original nine supported services should be forward-looking costs generated by an economic model (i.e., the HAI model), nothing in the language of the PUA requires that "economic costs" be forward looking. GCHC further states that the funding requests and amounts authorized by the Commission actually were based on revenue deficiencies for each carrier calculated using a rate of return analysis and not economic costs, encapsulated into a form to be submitted by each carrier seeking funding called the Schedule 1.01. (*Id*. at 15-16, citing *Second Interim IUSF Order* at 5-14, 17, 36-37; *In re Alhambra-Grantfork Tele. Co.*, ICC Docket No. 04-0354 Order (October 19, 2005) at 26-27 ("*Alhambra*"))

In GCHC's view, this approach has many shortcomings. Mr. Scott Rubins (who was himself involved in originally developing the Schedule 1.01), testified that currently there is no direct link between the actual economic costs of supported services and the amount of IUSF received by carriers under the rate of return approach, and it can create disincentives for a carrier to control its costs. Mr. Rubins supported these conclusions with specific examples of how the rate of return methodology can eliminate the incentive for a rate of return carrier operating as a "cost company" to act efficiently. GCHC points to language in prior Commission orders criticizing the rate-of-return methodology used to date to fund the IUSF.

The Commission also has expressed that this approach "was a stopgap measure, which might be inadequate for future use," and that "[n]othing requires the Commission to use the same generic criteria used in establishing the USF and eligibility for USF support when evaluating a individual LEC's request for additional subsidization." The Commission has stated that if an alternative approach is proposed, it "will be duly considered." (GCHC draft order at 16, citing *Alhambra* at 27) Thus, GCHC claims that the Schedule 1.01 rate of return analysis the Commission has authorized to be used in the past is not necessary for meeting the statutory requirements related to IUSF, and that the Commission is not bound to use the same criteria to determine IUSF eligibility and funding in the future.

It is in this context that GCHC proposes an alternative approach to determine "economic costs" and funding in connection with the addition of Access to Broadband Services as a supported telecommunications service. GCHC proposes that a carrier may elect to have its IUSF eligibility and funding determined by using its actual invoiced costs for Access to Broadband Services each year to act as the "economic costs" for that service, "to be compared to the annualized affordable rate for Access to Broadband Services during that year (the carrier's number of lines * 12 * $15.46) to see if those costs exceed the affordable rate." (GCHC draft order at 16; GCHC Ex. 1.0 at 9; 5.0 at 9) A carrier's "economic costs" for Access to Broadband Services would be its actual invoiced costs for "plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information

services." (GCHC 5.0 at 12-13) GCHC argues that the actual cost spent on this supported service is "true non-disputable economic cost." If a carrier spends more than its annualized affordable rate for Access to Broadband Services on such items in a year, as demonstrated with invoices showing such costs, then the carrier would be eligible for IUSF funding in the amount of that difference. (GCHC draft order at 16-17)

GCHC offers three reasons why using a carrier's historic actual invoiced costs for spending on Access to Broadband Services as economic costs for IUSF funding is appropriate. First, GCHC states that in its more recent orders concerning IUSF, the Commission itself has indicated an interest in examining individual carrier's actual costs associated with providing the telecommunications services supported by universal service funding. *In re Illinois Independent Telephone Association*, ICC Docket Nos. 00-0233/00-0355 Cons. (Fourth Interim Order Apr. 7, 2004) at 8 ("*Fourth Interim IUSF Order*"); *In re Illinois Independent Telephone Association*, ICC Docket Nos. 00-0233/00-0355 Cons. (Order Sept. 29, 2009) at p. 6 ("*Final IUSF Order*"). The Commission stated that to address its concerns regarding IUSF funding would require "an individual examination of each LEC's actual costs of providing supported services and whether those costs are reasonable." *Final IUSF Order* at 13. GCHC reasons that its proposal to use actual invoiced costs for Access to Broadband Services meets this concern expressed by the Commission by tying the actual costs for the supported service to funds provided from the IUSF. (GCHC draft order at 17)

GCHC's second reason "for why using actual invoiced costs for Access to Broadband Services to serve as proxy costs for IUSF funding is superior to the current HAI forward looking cost modeling and rate of return analysis is that it will create a direct link between a carrier's real cost of a supported service and the amount of IUSF received by the carrier." (*Id*.) By tying IUSF funding to a carrier's actual costs for spending on Access to Broadband Services, the Commission can be sure that the public funds received by the carrier are used for their actual intended purpose. GCHC states that under its proposal, there would be actual proof and accountability that a carrier was investing in a supported service. This would protect against the use of IUSF funding for inappropriate items that carriers have been able to or have attempted to subsidize through the rate of return method of determining IUSF funding. GCHC concludes that this approach is also consistent with the goal expressed by the FCC in the FCC/USF Order to "demand accountability" by requiring a showing that IUSF funds are being used for their intended purpose. (*Id.)*

Third, GCHC argues that using actual invoiced costs as economic costs is appropriate for Access to Broadband Services given the nature of this telecommunications service. According to GCHC, the Commission based its decision to use the forward-looking costs generated by the HAI model as the economic costs for the original supported services in the *Second Interim IUSF Order* because it was consistent with how the term "economic costs" generally was recognized in proceedings "dealing with telephony." GCHC relies on the Supreme Court of Illinois' decision in *Illinois-Indiana Cable Telephone Association v. Illinois Commerce Commission*, in which the Court determined that "telecommunications services" is much broader than

"telephony." 55 Ill. 2d 205, 219. GCHC argues that the past general understanding of "economic costs" with respect to traditional voice telephone service may not be applicable to all "telecommunications services," and that this is the case with respect to Access to Broadband Services. In GCHC's view, its proposed definition of Access to Broadband Services – consistent with the PUA's definition of "telecommunications services" in Section 13-203 – is plant that provides access to advanced telecommunications and information services. The economic costs of such a service, therefore, are the actual monies spent on investment in such plant facilities – i.e., the cost of purchasing and installing plant that provides or supports the provision of broadband as defined in the FCC/USF Order. (GCHC draft order at 17-18)

GCHC further proposes that the amount of a carrier's funding determined under this method be capped at an amount equal to the carrier's annualized affordable rate, "in order to protect the size of the IUSF from growing out of control." (*Id*.) GCHC believes this approach "will serve the same purpose that the rate-of-return results serve vis-à-vis the HAI model results for economic costs in the current approach to IUSF funding previously established by the Commission. See Alhambra at pp. 26-27 ('the ROR result is sometimes described as a limit or cap on the amount of funding to be allowed')." (*Id*.) GCHC asserts that no party expressed opposition to this portion of GCHC's proposal. GCHC also proposes that the Commission "establish an eight-year expiration date on the IUSF to hardwire in a review of the fund to determine whether there exist[s] a continuing need for the fund in the future." (*Id.* at 18*)*

Based upon its proposals, GCHC requests the Commission establish that IUSF funding be available for Geneseo, Cambridge and Henry County in the amounts of $1,100,319, $222,438 and $207,040, respectively, based on their number of access lines. GCHC proposes that to implement this funding plan, GCHC have up to 60 days from the date of the final Order in these dockets to submit its annual spending on Access to Broadband Services for the calendar year 2012 to determine the amount of IUSF funding it would be eligible for in 2013, up to the cap. Under the GCHC proposal, for each subsequent year, the carriers would submit their invoices to demonstrate actual costs for Access to Broadband Services in the previous year no later than the last day of February, which will be used to determine the amount of IUSF funding for that year, up to the cap. Further, if an electing carrier fails to claim any amounts in a given year, then that amount would be used to offset the following year's contribution rate. (GCHC Ex. 1.0 at 9)

3. GCHC Reply to Other Parties

GCHC reiterates its contention that the main focus of the *ICC/USF Transformational Order* is broadband. (GCHC draft order at 26) IITA and AT&T Illinois are attempting to ignore that the "overarching purpose" of the FCC in issuing the *ICC/USF Transformational Order* was to redefine "universal service" so that it now includes both voice and broadband. (*Id*.)

GCHC rejects the arguments made by the IITA and AT&T Illinois that the FCC's decision not to add "Access to Broadband Services" to its list of "services designated for support" in 47 C.F.R. § 54.101(a) supports the conclusion that the Commission should not add Access to Broadband Services as an Illinois supported telecommunications service. First, GCHC repeats that the Harrisonville case requires the Commission to look at both the "words" and "deeds" of the FCC and the FCC made clear through the *ICC/USF Transformational Order* that USF funding is now to be spent on access to broadband service. Second, Section 13-301(2)(a) of the Act set the FCC's list of supported services as a minimum. In other words, GCHC argues, "while the FCC's actions establish a floor for Illinois universal service, they are by no means are to be the ceiling." (*Id*.)

In GCHC's view, "it is important not to further delay making 'any real change' to the IUSF, as the approach of the IITA, AT&T Illinois and Staff would have this proceeding result in only more money being spent to support traditional landline service." (*Id*.)

GCHC "rejects AT&T Illinois's argument that Section 13-804 bars Access to Broadband Services from being made an Illinois supported telecommunications service because setting an affordable rate does not require broadband carriers actually to charge that rate, and therefore is not rate regulation and, to the extent adding Access to Broadband Services would require carriers to provide it, that is already required by the FCC through the *ICC/USF Transformational Order*." (GCHC draft order at 27) Also, GCHC disputes AT&T Illinois' suggestion that GCHC took the position that "broadband must be made affordable" or otherwise sought broadband "price relief." (GCHC Ex. 5.0 at 15)

GCHC argues that its proposal for IUSF funding complies with the requirements of Illinois law contrary to arguments by the IITA because it does not deny IUSF support for other services. (GCHC RB at 15-16) The IITA's position fails to address the difference between using invoices for amounts actually spent on Access to Broadband Services as a proxy cost for determining funding levels under Section 13-301(d)(1) and not supporting all of the supported services. As clarified by Mr. Rubins in his testimony, GCHC's proposal is an alternate method for determining the level of support for which a company is eligible by using actual invoiced costs as proxy costs. (GCHC Ex. 5.0 at 9)

Once a carrier would receive its funding under GCHC's alternative method, those funds could be spent to support any or all of the supported services as the carrier sees fit. (GCHC Ex. 5.0 at 9) This would be no different than exists under the current IUSF, where a recipient is not under any obligation to prove how it actually spent the IUSF funds it receives. Accordingly, GCHC argues that "contrary to the IITA's assertion, GCHC's proposal would not force a carrier to choose not to fund or provide any of the established supported telecommunications services." (GCHC draft order at 28; RB at 15-16)

B. IITA Position

The IITA recommends that the GCHC proposal be rejected. The Geneseo Companies propose to expand the list of supported services to include a 10th service they call "Access to Broadband Services." The IITA "joins the Staff and AT&T Illinois in their opposition to the alternative IUSF plan proposed by the Geneseo Companies." (IITA IB at 27)

Among its other shortcomings, the Geneseo Companies' proposal is inconsistent with the PUA in the IITA's view. (*Id*.) For example, the Geneseo Companies' proposal fails to provide funding for all supported services. According to Section 13-301(2)(a) of the PUA, the Commission is required to "define the group of services to be declared 'supported telecommunication services' that constitute "universal service." That same section of the PUA requires that this group of services "shall, at a minimum, include those services as defined by the Federal Communications Commission and as from time to time amended." Although the FCC has redefined the supported services, as discussed above, it has not eliminated the substance of any of the nine service previously listed by the FCC and currently included in the IUSF. (*Id*. at 28, citing 47 C.F.R. § 54.101)

As proposed by the Geneseo Companies, an IUSF recipient would have to choose whether to receive the level of funding for the current nine supported services or the level of support the Geneseo Companies' plan provides for "Access to Broadband Services," but not both. As explained by the Geneseo Companies, "…GCHC's plan calls for a company to be able to choose either the old IUSF amount or the new capped amount. GCHC desires to invest in Access to Broadband Services, but other companies may elect to continue to invest only in the original nine supported services. Although GCHC would prefer that all companies go to the new funding calculation, this provision is being placed into GCHC's plan in order to provide some flexibility for carriers' investment decisions." (IITA IB at 28, citing GCHC Ex. 1 at lines 239-245)

As a result, companies receiving support for Access to Broadband Services would receive no support for the nine voice services currently supported in Illinois, despite the unambiguous requirements of the PUA. (IITA IB at 28)

The Geneseo Companies' plan also fails to address adequately the requirements related to economic costs contained in the PUA. Section 13-301(1)(d) provides for a universal service support fund to be established by the Commission for eligible telecommunications carriers "whose economic costs of providing services for which universal support may be available exceed the affordable rate established by the Commission for such services . . . less any federal universal service support received for the same or similar cost of providing the supported services."

At page 14 of its Second Interim Order in the Prior Consolidated Dockets, the Commission reached the following conclusion, "The Commission has reviewed the statute and the arguments of the parties and concludes that the use of a forward-looking

cost model is appropriate in setting the legislatively permitted proxy cost for services eligible for USF support. The term 'economic costs' is undefined in the statute but its use is pervasive in Commission proceedings dealing with telephony where it has generally been recognized as involving forward-looking costs, as opposed to embedded costs."

According to the IITA, the Geneseo Companies' plan ignores this past Commission determination and creates its own definition of "economic costs" without reference to statutory requirements or Commission interpretations. The Geneseo Companies define economic costs as "actual invoice cost for capital, installation and improvement costs" for the direct deployment of Access to Broadband Services. It would also appear that the Geneseo Companies' proposal does not provide for the recovery of ongoing economic costs of providing Access to Broadband Services, but only for the initial investment costs of providing such service. Furthermore, the Geneseo Companies' proposal nowhere takes into account the federal support that a company may receive in relation to such investments. The Geneseo Companies' proposal fails the PUA's requirement of proving "economic costs." As Staff witness Jeffrey Hoagg observed, "GCHC [the Geneseo Companies] has not provided any analyses, proposed approach or any estimates of the economic (forward looking) costs of providing any current IUSF supported service." (IITA IB at 29, citing Staff Ex. 1.0 at lines 610-612)

The Geneseo Companies' plan is also not supported by the FCC's recent actions. Specifically, the FCC had the opportunity to add some form of broadband in its *ICC/USF Transformational Order*, but declined to do so. The FCC order provides no basis or reason for this Commission to add Access to Broadband Services. (IITA IB at 29)

C. AT&T Illinois Position

Section V of AT&T's initial brief is titled, "The Commission Should Not Add "Access to Broadband Service" as a Supported Service under the IUSF in this Proceeding." (IB at 10)

According to AT&T, Access to broadband should not be added as a supported service in this proceeding for several reasons. First, GCHC has failed to establish how what it is seeking could be a "supported telecommunications service" provided to an end-user customer.

According to AT&T, Section 13-301(1)(d) of the Act empowers the Commission to create a universal service fund for high cost carriers. Section 13-301(2)(a) states that the Commission in doing so shall define the "group of services" to be declared "supported telecommunications services" that "constitute universal service." The "key component" missing from GCHC's proposal is that "access to broadband" is not a telecommunications service. This is illustrated by GCHC's struggle to define what it meant by the term "access to broadband service." (*Id*.)

In the testimony submitted by GCHC, its definitions for the term "Access to Broadband Service" were based not on a service to be sold to an actual end user, but on a part of the network infrastructure. GCHC's witness, Scott Rubins, began by describing what would be covered by Access to Broadband as a "…category [that] includes all equipment and services necessary to provide or that is related to the transmission component of Broadband services." (GCHC Ex. 1.0 at 6) In the next round of testimony, he described "Access to Broadband Service" to "include all facilities associated with the delivery of Broadband Services from the service provider to a dedicated access point." (GCHC Ex. 2.0 at 5) In Supplemental Direct, Rebuttal and Additional Rebuttal Testimony, he then suggested that the definition of "Access to Broadband Service" is found in the FCC's amendment to 47 C.F.R. § 54.7 ("plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services"). (GCHC Ex. 3.0 at 8; GCHC Ex. 4.0 at 4)

There is one common theme to each of these definitions. GCHC is really asking that the definition of the term "Access to Broadband Service" be based on how the Illinois USF-funded carrier would be able to spend funds received, not on a specific service that would be available to an end user customer, i.e., a supported service. Section 13-301(1)(d) and (2)(a) require that eligible IUSF services be a "supported telecommunications service." (AT&T IB at 11)

Second, at the time GCHC filed its petition and the first two rounds of testimony in this proceeding, the FCC had not yet issued its *ICC/USF Order*. When the FCC did issue its Order, it explicitly stated that it would not add "access to broadband service" to the list of services supported by the Federal USF. *ICC/USF Order*, ¶65. Instead of adding "access to broadband service" as a supported service, the FCC modified the list of services supported by the federal USF, but retained the focus of federal USF support on voice telephony. 47 C.F.R. §54.101 states that "[v]oice telephony service shall be supported by federal universal service support mechanisms."

The federal rules further states that "[t]he functionalities of eligible voice telephony services include voice grade access to the public switched network or its functional equivalent; minutes of use for local service provided at no additional charge to end users; access to the emergency services provided by local government or other public safety organizations, such as 911 and enhanced 911, to the extent the local government in an eligible carrier's service area has implemented 911 or enhanced 911 systems; and toll limitation for qualifying low-income consumers (as described in subpart E of this part)." In AT&T's view, the FCC's *ICC/USF Order* further supports the conclusion that "access to broadband service" should not be added as a supported service under the Illinois USF in this proceeding. (AT&T IB at 11-12)

The FCC did clarify that carriers could use their federal USF support to build an advanced network, but did not change the methodology upon which a carrier's current support levels are developed. While 47 U.S.C. §254(f) provides, for purposes of a state

USF, that "[a] State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service," this suggests to AT&T that the Illinois Commission could allow carriers to use their state USF support to build or support an advanced network without being inconsistent with federal rules, so long as the carrier continued to offer the supported services adopted by the FCC in its earlier order. This does not mean, however, that "Access to Broadband" should be a supported service under the Illinois USF as demanded by GCHC. (*Id.* at 12)

Third, as discussed above, GCHC fails to demonstrate that what it is seeking to offer could be a "supported telecommunications service" under the Illinois USF. In fact, the FCC did not classify Broadband as a telecommunications service. The FCC noted that "Section 254 grants the Commission the authority to support not only voice telephony service but also the facilities over which it is offered…. we believe Congress granted the Commission the flexibility not only to designate the types of telecommunications services for which support would be provided, but also to encourage the deployment of the types of facilities that will best achieve the principles set forth in Section 254(b)…." *FCC's ICC/USF Order*, ¶64. The FCC used Section 706 of the Telecommunications Act of 1996 as a source for its authority to require carriers to provide broadband as a condition of receiving federal USF support. The FCC stated that "Section 254 grants the Commission clear authority to support telecommunications services and to condition the receipt of universal service support on the deployment of broadband networks, both fixed and mobile, to consumers. Section 706 provides the Commission with independent authority to support broadband networks in order to 'accelerate the deployment of broadband capabilities' to all Americans." *FCC ICC/USF Order*, ¶60. (AT&T IB at 13)

Finally, AT&T argues that the Illinois PUA precludes adding "access to broadband service" to the list of IUSF-supported services. Section 13-301(2)(a) describes "supported telecommunications services." Broadband is not a telecommunications service. In addition, Section 13-804 of the PUA addresses Broadband service and provides that "[e]xcept to the extent expressly permitted by and consistent with federal law, the regulations of the Federal Communications Commission, this Article, …or this amendatory Act of the 96th General Assembly, the Commission shall not regulate the rates, terms, conditions, quality of service, availability, classification, or any other aspect of service regarding …broadband services…." (*Id*.)

GCHC argued in its testimony that its proposal would not result in the regulation of broadband (GCHC Ex. 3.0 at 8-9), but this would simply not be the case in AT&T's view. If the Commission added "access to broadband service" as a supported service, Section 13-301 appears to require that an "affordable price" be set for the service. Much of GCHC's rationale for adding access to broadband service to the list of supported services was that broadband must be made affordable because some of those who do not subscribe to broadband cited cost of service as a factor in not having broadband service. (GCHC Ex. 1.0 at 7-8) If the affordability price proposed by GCHC initially (GCHC Ex. 1.0 at 7-8) does not set the rate a carrier will charge for broadband

services, then GCHC would be in a situation where, without rate-setting authority by the Commission, the proposal fails to provide the price relief that GCHC claimed is a key component of their proposal. Setting rates for broadband service is contrary to the Illinois statute's prohibition on the regulation of broadband. (AT&T IB at 15)

In its reply brief, AT&T Illinois argues that the Affordable Rate proposed by GCHC is Inconsistent with Section 13-301 of the Act. (RB at 27)

According to AT&T Illinois, there are several problems with GCHC's proposed affordable rate of $15.46. First, under Section 13-301(1)(d), the Commission is required to establish an "affordable rate" for the telecommunications services supported by the USF. Section 13-301(2)(c) further states that the Commission shall "establish an affordable price for the supported telecommunications services for the respective incumbent local exchange carrier" and that the "affordable price shall be no less than the rates in effect at the time the Commission creates a fund…."

At the time testimony was filed earlier in this case, Geneseo's internet access rates were over three times and eight times above $15.46. Thus, $15.46 would not comply with the statutory requirement that the "affordable price" be no less than the rates in effect at the time the Commission creates the fund or in this case would be modifying the fund to add another supported service. Last year, when the second round of testimony in this case was filed, Geneseo's rates for internet access ranged from $49.95 for a download speed of 965kbps to $128.95 for download speeds up to 24Mbps. (AT&T Illinois Ex. 1.1 at 15) Thus, the proposed affordable rate of $15.46 does not comply with the requirements of Sections 13-301(1)(d) and 13-301(2)(c) because it is significantly less than the rates in effect at the time GCHC advocated it be added as a supported service. (AT&T RB at 28-29)

GCHC states that "[t]he 'affordable rate' established by the Commission is not the rate that a carrier must charge customers for a supported service (emphasis in original)." (GCHC IB at 19) Quoting from Mr. Rubins' testimony, GCHC notes with respect to the current IUSF that "it charges $17.67 per month on average for basic local service while the 'affordable rate' for the existing nine supported services is $20.39 per month." (*Id*.) According to AT&T Illinois, this is a very different situation if the local funded carrier is now charging less than the $20.39 affordable rate established by the Commission in Docket Nos. 00-0233/0335. In fact, if a currently funded carrier charges less than the established affordable rate of $20.39, the revenues for the difference between the $20.39 affordable rate and the $17.67 charged rate will be "imputed" to the carrier's revenues for purposes of determining the level of support that carrier will be eligible to receive under the current IUSF. In Geneseo's case at least, it is charging considerably more than the affordable rate it is asking the Commission to establish for "access to broadband service", which is impermissible under Section 13-301. (AT&T RB at 29)

GCHC's calculations are based on an FCC survey conducted by the FCC during October and November 2009. This survey was conducted as part of a requirement

under the American Recovery and Reinvestment Act to explore the broadband experience of American consumers. The survey was not used to develop an affordable rate, "only the consumers' willingness to pay for the service, which is not the same as an affordable rate." (AT&T RB at 29; AT&T Ex. 1.1 at 15) GCHC argues that 36% of the Americans surveyed stated that cost was the reason why they did not have access to broadband services, but fails to note that only 15% of the non-adopters (those without broadband access) cite monthly cost of service as the main reason for not having internet access. (*Id*.) In AT&T's view, GCHC is inconsistent, on the one hand arguing that the affordable rate is not the rate it must charge for "access to broadband service," but then citing the "monthly cost of service" as prohibitive to broadband adoption. (AT&T RB at 29-30)

In Section IV.B.2 of its reply brief, AT&T argues, "GCHC's Proposal Would Not Support All of the Services Currently Supported by the IUSF." Under GCHC's proposal, it could select support for access to broadband services while the other funded carriers would continue to receive support for the current IUSF-supported services. According to AT&T, this is inconsistent with the requirements of Section 13-301. Section 13-301(2)(a) clearly states that the "supported telecommunications services" shall "at a minimum, include those services as defined by the Federal Communications Commission and as from time to time be amended." (AT&T RB at 30-31)

Section IV.B.3 of AT&T's reply brief is titled, "GCHC's Method for Calculating USF Support for Access to Broadband Services Creates Opportunities for Inefficiencies and Fraud."

With respect to the "economic costs" of "Access to Broadband Services," GCHC proposes that the Commission adopt a different approach than the rate of return analysis that has been the basis for determining economic costs for the other nine supported telecommunications services since the IUSF was established over 10 years ago. GCHC's proposal is that the Commission should instead use the "actual costs a carrier spends in excess of the affordable rate per line per year on plant or facilities that provide or support the provision of broadband service, as established by actual invoices evidencing the expenditures." (AT&T RB at 31, citing GCHC IB at 23)

According to AT&T Illinois, GCHC's proposed method for calculating the level of USF support would create many opportunities for fraud and inefficiencies. In support of its proposal to use actual costs, GCHC argues that while the Commission could continue to use the Schedule 1.01 rate of return analysis, there are many "shortcomings," which GCHC argues lead to a disincentive for carriers to control costs. AT&T Illinois argues that if the Commission adopted GCHC's proposal to rely on "actual invoices" provided by the funded carrier as a demonstration of its costs, there would be no control over that funded carrier's rate of return. AT&T argues, "There would be no overall review of the carrier's cost—just the 'costs' identified on a particular invoice. While there are some flaws with the use of the Form 1.01, it at least provides a cap." (AT&T RB at 31)

GCHC states that a carrier electing to receive support for access to broadband (rather than the other supported services) could use those funds to support one of the other supported services. (GCHC IB at 28) Under GCHC's proposal, GCHC could submit an invoice for one of its "economic costs" of providing "access to broadband service," but use it for an entirely different supported service. This further illustrates why GCHC's invoice approach should not be adopted, in AT&T Illinois' view.

According to AT&T, absent any type of earnings review, which is what GCHC is advocating, there is the potential for multiple recoveries of the same "costs." For example, if GCHC charged $100 for Internet access service, it could receive revenues from its customers, revenues from the IUSF and potentially revenues from the federal USF allowing a carrier to recover on a three-to-one basis for its "costs." Under GCHC's proposal, all the carrier would have to do is show a receipt and that amount would become part of its economic costs. (AT&T RB at 32)

D. Staff Position

As explained in its testimony and briefs, Staff's view is that the Commission should reject Geneseo's arguments, and deny its request. (Staff RB at 1)

1. GCHC Proposal to Add Broadband to Group of Supported Services

As an initial matter, Staff supports making broadband services available to all Illinoisans. The policy of the State is to foster the deployment and adoption of broadband services. (*Id*., citing 20 ILCS 661/1, et seq.) Likewise, Staff believes the Commission has the authority to determine that broadband services be supported. Section 13-301(2)(a) of the Public Utilities Act authorizes the Commission to: "[d]efine the group of services to be declared 'supported telecommunications services' that constitute 'universal service'." 220 ILCS 5/13-301(2)(a).

Whether the Commission should determine that broadband services be supported by the IUSF in this phase of the proceeding is another question altogether. Geneseo argues that the FCC has effectively declared broadband to be a supported service, and that broadband is therefore, by operation of law, an IUSF-supported service in light of the Illinois statutory mandate that IUSF-supported services: "shall, at a minimum, include those services … defined [as such] by the [FCC] … as from time to time amended." 220 ILCS 5/13-301(2)(a). (Staff RB at 2)

In response, Staff argues, "This is simply not the case, however. The FCC has done no such thing." (*Id*.) In fact, the FCC's revised rule defining federally-supported services reads in its entirety as follows:

> (a) Services designated for support. *Voice Telephony services shall be supported by federal universal service support mechanisms*. Eligible voice telephony services must provide *voice grade access* to the public switched

> network or its functional equivalent; minutes of use for local service provided at no additional charge to end users; access to the emergency services provided by local government or other public safety organizations, such as 911 and enhanced 911, to the extent the local government in an eligible carrier's service area has implemented 911 or enhanced 911 systems; and toll limitation services to qualifying low-income consumers as provided in subpart E of this part.
>
> (b) An eligible telecommunications carrier must offer voice telephony service as set forth in paragraph (a) of this section in order to receive federal universal service support.
> 47 C.F.R. §54.101 (emphasis added)

According to Staff, "The FCC's rule calls for support of "voice telephony services" and the provision of "voice grade access", which – it need hardly be said – is not broadband. Broadband is not mentioned in the FCC rule. In short, Geneseo's argument that the Commission is required to declare broadband a supported service by operation of Section 13-301(2)(a) fails from the outset." (Staff RB at 3)

Geneseo concedes that the FCC did not add access to broadband to the list of federally-supported services; however, Geneseo advances another rationale for the "ostensible requirement" that the Commission approve IUSF funding for broadband services. Geneseo points to the FCC's statement that it will "require that recipients use their support in a manner consistent with achieving universal availability of voice and broadband." *FCC/USF Order*, ¶205 (see also Geneseo IB at 6-7) Further, Geneseo notes that the FCC amended Rule 54.7 to read, in relevant part that "[t]he use of federal universal service support … shall include investments in plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services." 47 C.F.R. §54.7(b). According to Geneseo, these two pronouncements, taken together, amount to an FCC declaration that broadband is a supported service. (Staff RB at 3)

According to Staff, "This argument requires one to infer that the FCC added broadband to the list of supported services "by implication," a curious argument when the FCC specifically declined to add broadband to the list of supported services in its actual rule." (*Id*. at 4) In Staff's view, the Commission should not give any credence to this argument.

Moreover, the fact that the FCC rules require carriers receiving high-cost support to make "investments in plant that can, either as built or with the addition of plant elements, when available, provide access to advanced telecommunications and information services[,]" does not amount to a determination that broadband is a supported service. Rather, this requirement is easily reconciled with the FCC's actual ruling that broadband is not a supported service. (Staff RB at 4)

In implementing its amended Rule 54.101, the FCC favorably cited comments which noted that: "[f]iber networks are . . . more efficient, and more reliable than the legacy copper network. … [and] are cheaper to maintain and have fewer potential points of failure than copper lines." *Report and Order and Further Notice of Proposed Rulemaking*, ¶64, n.72, In the Matter of Connect America Fund / A National Broadband Plan for Our Future / Establishing Just and Reasonable Rates for Local Exchange Carriers / High-Cost Universal Service Support / Developing an Unified Intercarrier Compensation Regime / Federal-State Joint Board on Universal Service Lifeline and Link-Up / Universal Service Reform – Mobility Fund, FCC No. 11-161, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket No. 10-208 (Adopted: October 27, 2011; Released: November 18, 2011) (*ICC/USF Order*).

The FCC further observed that "the forward-looking cost of deploying voice- and broadband-capable networks today is generally not significantly higher than deploying voice-only networks[,]" and that, accordingly, "although [the FCC is] updating the high cost fund to support modern voice and broadband networks, [it is] not increasing the overall size of the fund to do so." (*Id*.) In Staff's view, it is clear that the FCC directed carriers to use high-cost support, not necessarily to build out broadband facilities, but to build voice facilities that are broadband-capable, such as fiber-optic networks. Furthermore, the FCC was confident that the broadband-compatibility requirement would not increase the fund size, whereas Geneseo's proposal will do so. In other words, the FCC rule is a "far cry from the requirement that Geneseo seeks to impose." (Staff RB at 4-5)

According to Staff, the FCC deliberately declined to add broadband access to the list of federal USF supported services. It chose instead to direct federal USF funding to recipients with networks capable of providing broadband services. On balance, this FCC decision undercuts Geneseo witness Mr. Rubin's position that the Illinois Commerce Commission should add broadband access to the list of Illinois supported services in this proceeding. (Staff Ex. 4.0 at 9)

Furthermore, even if one is prepared to accept the notion that broadband service should be supported, there remains the issue of how to define broadband service. According to Staff, Geneseo here again provides little insight. As AT&T Illinois correctly observes, Geneseo has advanced three definitions in this proceeding. Staff agrees with AT&T Illinois that "[t]here is one common theme to each of these definitions. [In each, Geneseo] is really asking that the definition of the term 'Access to Broadband Service' be based on how the [I]USF-funded carrier would be able to spend fund received, not on a specific service that would be available to an end-user customer, i.e., a supported service." (Staff RB at 5-6, citing AT&T IB at 11)

According to Staff, Geneseo's position is at odds with both state and federal policy, "which stand for the proposition that end-user customers, not subsidized companies, are intended to be the beneficiaries of high cost support." (Staff RB at 5-6, citing 220 ILCS 5/13-102(a) (''universally available and widely affordable

telecommunications services are essential to the health, welfare and prosperity of all Illinois citizens"); 47 U.S.C. §254(b)(3) ('Consumers in all regions of the Nation, including … those in … high cost areas, should have access to telecommunications and information services … that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas").

2. Economic Costs and Affordable Rate

Staff next argues, "Instead of using the economic costs of providing broadband service to set the subsidy amount, as required by Section 13-301(1)(d), Geneseo proposes to use 'actual invoiced costs'." (Staff RB at 6) In the proceeding that established the IUSF, the Commission found that, "[t]he term 'economic cost' is undefined in the statute but its use is pervasive in Commission proceedings dealing with telephony where it has generally been recognized as involving forward-looking costs, as opposed to embedded costs." *Second Interim Order* at 14, Illinois Independent Telephone Association: Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act, ICC Docket Nos. 00-0233/00-0335 (Consolidated) (September 18, 2001). Here, Geneseo is proposing to define economic costs as embedded costs, "in a manner contrary to Commission Order and the statute." (Staff RB at 6-7)

In Staff's view, Geneseo's methodology for calculating an "affordable rate" should likewise be rejected. Geneseo proposes a rate that is purported to "(a) represent an amount all customers in Illinois could 'afford,' including low income customers, and (b) be an amount that would promote the concept of this service being 'universal' – i.e., that virtually all customers would be willing to pay the rate to purchase the service." (Staff RB at 7, citing GCHC IB at 20-21) In fact, what Geneseo does is take the average monthly cost of broadband services – calculated to be $41.00 – and divide it by 37.7%, yielding $15.46. This is ostensibly: "[t]o equalize the impact of the cost for Access to Broadband Services on an average family at the poverty level to that of a household with a median level of income[,]" the former being 37.7% of the latter. (Staff RB at 7, citing GCHC IB at 21)

According to Staff, "This would be laudable if Geneseo was planning to offer broadband services to some discrete group of impoverished Illinoisans. As far as is known, it is not, however." Staff continues, "Geneseo's proposed affordable rate is not intended to benefit Illinoisans of modest means, but rather to be used to determine the subsidy amount Geneseo would receive under its proposal. Baldly put, the lower the affordable rate, the higher the subsidy Geneseo receives." (Staff RB at 7)

The key to establishing an affordable rate for a service is setting it at a level reasonably comparable to rates charged elsewhere. (Staff RB at 7-8, citing 47 U.S.C.

§254(b)(3)) In its Second Interim Order, the Commission established the affordable rate for supported telecommunications services by using a Verizon (now Frontier) rate that was then paid by Verizon customers in Verizon service territories "comparable to IITA members with respect to customer density, economic demographics, and operational requirements." *Second Interim Order* at 32. The Commission further found that "[t]he [affordable] rate [adopted] is also reasonably comparable to rates in urban areas." (*Id*.)

In the context of this proceeding, it is clear that the only "reasonably comparable" rate in evidence is $41.00, that being the average monthly cost for broadband service throughout the country. (Staff RB at 8) Geneseo's "affordable rate", in contrast is set at less than 38% of that average monthly cost. This is in no way "reasonably comparable" to what other U.S. or Illinois customers pay. Staff argues that Geneseo's affordable rate calculation "is fatally defective and must be ignored." (*Id*.)

Staff also contends that "[t]he Commission need not set an affordable rate for a service not supported by the IUSF, and it should not on this record declare access to broadband a supported service." (*Id*. at 7)

E. Commission Analysis and Conclusion

Section 13-301(2)(a) provides, in part, that "In any order creating a fund pursuant to paragraph (d) of subsection (1), the Commission … shall [d]efine the group of services to be declared 'supported telecommunications services' that constitute 'universal service.'" There are currently nine such supported services.

GCHC proposes to add Access to Broadband Services as a supported telecommunications service eligible for IUSF funding and also proposes an alternative method of determining its IUSF funding. Staff, AT&T Illinois, the IITA and the IITA Member Intervenors oppose the GCHC proposal.

Based on the record, GCHC believes the Commission should conclude "that the time has come to revise and modernize the IUSF, just as the FCC acted to modernize federal universal service in its *ICC/USF Transformational Order*." (GCHC draft order at 29)

GCHC argues that on the whole, the FCC in the *ICC/USF Transformational Order* made access to both voice and broadband service necessary components of universal service. GCHC asserts that one of the main purposes of the *ICC/USF Transformational Order* was to make sure universal service includes ensuring access to broadband and providing that universal service funding be used to ensure such access. According to GCHC, "Based upon the record evidence, adding Access to Broadband Services to the group of supported telecommunications services under Section 13-301(2)(a) is not only appropriate, but mandatory in light of the FCC's actions in the FCC/USF Order as a matter of Illinois law." (GCHC IB at 6)

Having reviewed the record, the Commission agrees with Staff, AT&T Illinois, the IITA and the IITA Member Intervenors that GCHC's proposal should not be adopted at this time.

As those parties explain, the FCC specifically declined to identify broadband as a supported telecommunication service by rule, and accordingly, the Commission is not bound to do so by operation of Section 13-301(d)(2)(a). (Joint draft order at 20; Staff RB at 2-3)

As Staff observes, broadband is not mentioned in the FCC rule. The FCC's rule calls for support of "voice telephony services" and the provision of "voice grade access," which is not broadband. (Staff RB at 3)

Rather than adding broadband to the list of supported services, the FCC took a different approach by requiring carriers receiving high-cost federal support to make investments in voice facilities that are broadband-capable, such as fiber-optic networks, without increasing the overall size of the USF fund to do so. Here, on the other hand, the GCHC proposal would increase the fund size. (Staff RB at 3-5)

The Commission also agrees with the concerns expressed by Staff and AT&T Illinois that GCHC's definitions of broadband service are at odds with both state and federal policy -- which stand for the proposition that end-user customers, not subsidized companies, are intended to be the beneficiaries of high cost support -- in that GCHC's definitions are not based on what service is provided to end-users, as is required by statute, but what facilities GCHC builds to provide them.

As indicated above, GCHC proposes to recover its "actual, invoiced" costs of deploying such facilities. According to Staff, IITA and AT&T Illinois, "This is contrary to statute, which calls for the use of economic costs; this Commission has long held economic costs to mean incremental or forward-looking costs." (Joint draft order at 20; Staff RB at 6-7)

Section 13-301(1)(d) of the PUA provides, among other things, that the Commission shall, "if appropriate, establish a universal service support fund from which local exchange telecommunications carriers … whose economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services…."

While the Commission is open-minded to the consideration of other measures of economic costs than those approved in past orders, the Commission does not believe the record in this case supports a finding that use of actual, invoiced costs provides a better measure of economic costs than the incremental or forward-looking costs that have been found appropriate in the past. The Commission agrees with Staff, IITA and AT&T Illinois that GCHC's proposal should not be approved in this proceeding.

As described above, GCHC proposes an affordable rate for access to broadband services that, based on its own evidence, is less that 38% of what the average U.S. or Illinois citizen pays for similar services. While the Commission is not obliged to establish an affordable rate for access to broadband services, as such services are not found to be supported services as explained above, the Commission observes that any affordable rate for broadband services should follow well-established universal service principles of comparability across regions. As indicated by Staff, IITA and AT&T Illinois, GCHC's rate does not do so.

VII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the record herein, finds that:

(1) Geneseo Telephone Company, Cambridge Telephone Company and Henry County Telephone Company ("GCHC"); the intervenors members of the Illinois Independent Telephone Association, or IITA, which consist of small, independent local exchange companies with fewer than 35,000 access lines ("IITA Member Intervenors"); Illinois Bell Telephone Company, d/b/a AT&T Illinois; Frontier North Inc., Frontier Communications of The Carolinas Inc., Citizens Telecommunications Company of Illinois, Frontier Communications – Midland, Inc., Frontier Communications – Prairie, Inc., Frontier Communications – Schuyler, Inc., Frontier Communications of Depue, Inc., Frontier Communications of Illinois, Inc., Frontier Communications of Lakeside, Inc., Frontier Communications of Mt. Pulaski, Inc., Frontier Communications of Orion, Inc. (jointly, "Frontier"), the members of the Cable Telecommunications & Communications Association and all other interveners in this proceeding are telecommunications carriers as defined by the Illinois Public Utilities Act;

(2) the Commission has jurisdiction over the parties and subject matter in this proceeding;

(3) the determinations made and conclusions reached in the prefatory portion of this Order hereinabove are hereby adopted as findings of this Order;

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that an interim updated Illinois Universal Service Fund in the amount of $18,984,628 to be allocated as shown in the Appendix to this Order and in Schedules 1 and 2 attached to the Staff initial brief filed September 14, 2012, plus administrative expenses (the "Interim Fund") shall, pursuant to Section 13-301(1)(d) of the Illinois Public Utilities Act, be implemented on the first day of the calendar month following by 60 days the date of this Order and shall, as of that date, supersede the current IUSF.

IT IS FURTHER ORDERED that all of the IITA Member Intervenors currently participating in this docket and receiving funds from the Interim Fund and all Frontier

companies currently participating in this docket and receiving funds from the Interim Fund shall on the first day of the calendar month following by 60 days the date of this Order reduce their intrastate originating switched access charges to a rate no greater than a rate that will mirror originating interstate switched access charges through tariff amendments which shall be effective on two business day's notice.

IT IS FURTHER ORDERED that not later than two years from issuance of this Order, one or more eligible recipients of IUSF, or an organization representing them such as the IITA, shall petition the Commission for approval of a longer-term IUSF to replace the Interim Fund. Such petition, and any resulting longer-term IUSF, shall be based upon a different methodology, absent a showing that no such alternative methodology is reasonably feasible.

IT IS FURTHER ORDERED that any longer-term IUSF replacing the Interim IUSF shall be: (i) compliant with the terms and requirements of Section 13-301 of the Illinois Public Utilities Act, (ii) consistent with and fully reflect the Commission's concerns and admonitions, as stated in its several Orders in Docket Nos. 00-0233/0335 and 04-0354, regarding continued use of a rate-of-return based methodology to determine IUSF support levels, and (iii) consistent with FCC policies and rules applicable on an interstate level to Illinois ILECs potentially eligible for IUSF support pursuant to Section 13-301(1)(d) of the Act.

IT IS FURTHER ORDERED that the Interim Fund shall remain in effect until the implementation of the longer-term IUSF.

IT IS FURTHER ORDERED that the supported services shall be as defined in 47 C.F.R. §54.101, and shall thus be "voice telephony services."

IT IS FURTHER ORDERED that $20.39 shall remain the "affordable rate" for purposes of the Interim Fund.

IT IS FURTHER ORDERED that the economic costs of providing the supported services for purposes of the Fund for the IITA Member Intervenors as a group and the Frontier Companies are, at a minimum, equal to the proxy costs of all supported services calculated by economic cost study results introduced into evidence.

IT IS FURTHER ORDERED that all local exchange carriers and interexchange carriers certificated in Illinois shall contribute to the Interim Fund on the basis of their intrastate retail revenues, consistent with Section 13-301(1)(d) of the Act.

IT IS FURTHER ORDERED that all carriers contributing to the Interim Fund shall timely provide to the Fund Administrator and Staff, in the first instance, all information necessary to determine each carrier's intrastate net retail revenues.

IT IS FURTHER ORDERED that all carriers contributing to the Interim Fund shall recover their fund contributions from their end-user customers via an explicit end-user

surcharge on the customer's bill. The surcharge shall be assessed in a competitively neutral manner consistent with existing Illinois rules and statutes.

IT IS FURTHER ORDERED that all carriers contributing to the Interim Fund shall be prohibited from recovering their funding commitments from another certificated carrier for any service purchased and used solely as an input to a service provided to such certificated carrier's retail customers.

IT IS FURTHER ORDERED that the Illinois Small Company Exchange Carriers Association, Inc. ("ISCECA") is reappointed as the Fund Administrator of the Interim Fund and shall follow the currently approved administrative rules.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED: January 17, 2013

Larry M. Jones
Administrative Law Judge